AASB Exposure Draft **ED 336**
November 2024

Provisions—Targeted Improvements

Proposed amendments to AASB 137

Comments to the AASB by 31 January 2025

Australian Government

Australian Accounting Standards Board

How to Comment on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 31 January 2025. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 12 March 2025.

Formal Submissions

Submissions should be lodged online via the "Current Projects – Open for Comment" page of the AASB website as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@aasb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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AASB REQUEST FOR COMMENTS

The Australian Accounting Standards Board's (AASB's) policy is to incorporate International Financial Reporting Standards (IFRSs) into Australian Accounting Standards. Accordingly, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(b) the 'AASB Specific Matters for Comment' listed below.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

   (a) not-for-profit entities; and

   (b) public sector entities, including GAAP/GFS implications;

2. whether, overall, the proposals would result in financial statements that would be useful to users;

3. whether the proposals are in the best interests of the Australian economy; and

4. unless already provided in response to specific matters for comment 1 – 4 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

November 2024

Exposure Draft

IFRS® Accounting Standard

Provisions—Targeted Improvements

Proposed amendments to IAS 37

Comments to be received by 12 March 2025

International Accounting Standards Board

IASB/ED/2024/8

Exposure Draft
Provisions—Targeted Improvements

Proposed amendments to IAS 37

Comments to be received by 12 March 2025

Exposure Draft IASB/ED/2024/8 is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by **12 March 2025** and should be submitted by email to commentletters@ifrs.org or online at https://www.ifrs.org/projects/open-for-comment/.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

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Introduction

What is the IASB proposing?

IN1 In this exposure draft, the International Accounting Standards Board (IASB) is proposing to make targeted improvements to three aspects of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*:

(a) one of the criteria for recognising a provision—the requirement for the entity to have a present obligation as a result of a past event (the present obligation recognition criterion); and

(b) two aspects of the requirements for measuring a provision—those relating to:

(i) the costs an entity includes in estimating the future expenditure required to settle its present obligation; and

(ii) the rate an entity uses to discount that future expenditure to its present value.

IN2 The IASB is also proposing amendments to the *Guidance on implementing IAS 37* Provisions, Contingent Liabilities and Contingent Assets (*Guidance on implementing IAS 37*). These amendments would update the guidance on applying the present obligation recognition criterion to reflect the proposed amendments to the requirements.

Amendments to the present obligation recognition criterion

What are the main aims of the proposed amendments?

IN3 The proposed amendments to the present obligation recognition criterion aim:

(a) to clarify the requirements, which have led to questions from stakeholders to the IFRS Interpretations Committee.

(b) to change the timing of recognition of some provisions. The amendments would affect provisions for costs, often levies, that are payable only if an entity takes two separate actions or if a measure of its activity in a specific period exceeds a specific threshold. Provisions for some of these costs would be accrued earlier and progressively instead of at a later point in time, to provide more useful information to users of financial statements.

IN4 The IASB started by developing a new definition of a liability and new concepts to support that definition, adding them to the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) in 2018. The amendments proposed in this exposure draft apply those concepts and would align the requirements of IAS 37 with the *Conceptual Framework*.

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What amendments are proposed to achieve the main aims?

IN5 The proposed amendments to the present obligation recognition criterion include:

(a) updating the definition of a liability in IAS 37 and the wording of the present obligation recognition criterion to align them with the definition of a liability in the *Conceptual Framework*;

(b) amending the requirements that support the present obligation recognition criterion, drawing on concepts from the *Conceptual Framework*;

(c) withdrawing IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and replacing it with an illustrative example in the *Guidance on implementing IAS 37*;

(d) withdrawing IFRIC 21 *Levies*, whose requirements are not consistent with those proposed in this exposure draft, and replacing it with illustrative examples in the *Guidance on implementing IAS 37*; and

(e) making other amendments to the *Guidance on implementing IAS 37*:

    (i) adding examples to illustrate fact patterns that have been the subjects of IFRS Interpretations Committee agenda decisions; and

    (ii) expanding the decision tree and updating the analysis in existing illustrative examples to align it with the proposed requirements.

Who would be affected by the amendments?

IN6 The proposed amendments to the present obligation recognition criterion would have widespread applicability. This criterion affects decisions about whether and when to recognise all types of provisions. Entities that are subject to levies and similar government-imposed charges are among those that are likely to be most significantly affected by the proposed amendments.

Amendments relating to the costs to include in measuring a provision

IN7 IAS 37 requires an entity to measure a provision at the best estimate of the expenditure required to settle its present obligation. The IASB proposes to specify that this expenditure comprises the costs that relate directly to the obligation, which include both the incremental costs of settling that obligation and an allocation of other costs that relate directly to settling obligations of that type.

IN8 The aim of this amendment is to clarify that an entity uses the same assessment of costs in measuring a provision as IAS 37 already requires it to use in determining whether a contract is onerous.

Amendments to the discount rate requirements

What is the main aim of the proposed amendments?

IN9 The main aim of the proposed amendments to the discount rate requirements is to reduce diversity in, and increase the transparency of, the discount rates entities use in measuring provisions, thereby improving the comparability of their financial statements.

IN10 Currently, some entities use risk-free rates whereas others use rates that include 'non-performance risk'—the risk that the entity will not settle the liability. Rates that include non-performance risk are higher than risk-free rates and result in smaller provisions. If two entities measure provisions using discount rates calculated on different bases, users of their financial statements might find it difficult to compare the entities' financial performance and financial position, especially if the entities disclose little information about the rates they have used.

What amendments are proposed to achieve the main aim?

IN11 The IASB proposes to specify that an entity discounts a provision using a risk-free rate—that is, a rate that excludes non-performance risk. The IASB proposes not to specify how an entity determines an appropriate risk-free rate, acknowledging that various approaches might be appropriate. The IASB instead proposes to require an entity to disclose the discount rates it has used and the approach it has used to determine those rates.

Who would be affected by the amendments?

IN12 The proposed amendments to the discount rate requirements would affect entities with provisions discounted to reflect the effect of the time value of money. The entities most affected are likely to be those with large long-term asset decommissioning or environmental rehabilitation provisions—typically entities operating in the energy generation, oil and gas, mining and telecommunications sectors.

Next steps

IN13 The IASB will consider comments it receives on the proposals in this exposure draft and will then decide whether and, if so, how to amend IAS 37.

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Invitation to comment

Introduction

The IASB invites comments on the proposals in this exposure draft, particularly on the questions set out below. Comments are most helpful if they:

(a) respond to the questions as stated;

(b) indicate the specific paragraph(s) to which they relate;

(c) contain a clear rationale;

(d) identify any wording in a particular proposal that is not clear or would be difficult to translate; and

(e) identify any alternative the IASB should consider, if applicable.

The IASB requests that comments be confined to the questions asked in this exposure draft. However, respondents need not answer all the questions in this invitation to comment.

Questions for respondents

Question 1—Present obligation recognition criterion
The IASB proposes: • to update the definition of a liability in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to align it with the definition in the *Conceptual Framework for Financial Reporting* (paragraph 10); • to align the wording of the recognition criterion that applies that definition (the present obligation recognition criterion) with the updated definition of a liability (paragraph 14(a)); • to amend the requirements for applying that criterion (paragraphs 14A–16 and 72–81); and • to make minor amendments to other paragraphs in IAS 37 that include words or phrases from the updated definition of a liability (Appendix A). The proposals include withdrawing IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies* (paragraph 108). Paragraphs BC3–BC54 and BC86 of the Basis for Conclusions and Appendix A to the Basis for Conclusions explain the IASB's reasoning for these proposals. Do you agree with these proposals? Why or why not? If you disagree, which aspects do you disagree with and what would you suggest instead?

Question 2—Measurement—Expenditure required to settle an obligation
The IASB proposes to specify the costs an entity includes in estimating the future expenditure required to settle an obligation (paragraph 40A). Paragraphs BC63–BC66 of the Basis for Conclusions explain the IASB's reasoning for this proposal. Do you agree with this proposal? Why or why not? If you disagree, what would you suggest instead?

Question 3—Discount rates
The IASB proposes to specify that an entity discounts the future expenditure required to settle an obligation at a rate (or rates) that reflect(s) the time value of money—represented by a risk-free rate—with no adjustment for non-performance risk (paragraphs 47–47A). The IASB also proposes to require an entity to disclose the discount rate (or rates) it has used and the approach it has used to determine that rate (or those rates) (paragraph 85(d)). Paragraphs BC67–BC85 of the Basis for Conclusions and Appendix B to the Basis for Conclusions explain the IASB's reasoning for these proposals. Do you agree with: (a) the proposed discount rate requirements; and (b) the proposed disclosure requirements? Why or why not? If you disagree, what would you suggest instead?

Question 4—Transition requirements and effective date
4(a) Transition requirements The IASB proposes transition requirements for the proposed amendments (paragraphs 94B–94E). Paragraphs BC87–BC100 of the Basis for Conclusions explain the IASB's reasoning for these proposals. Do you agree with these proposals? Why or why not? If you disagree, which aspects do you disagree with and what would you suggest instead? **4(b) Effective date** If the IASB decides to amend IAS 37, it will decide on an effective date for the amendments that gives those applying IAS 37 sufficient time to prepare for the new requirements. Do you wish to highlight any factors the IASB should consider in assessing the time needed to prepare for the amendments proposed in this exposure draft?

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Question 5—Disclosure requirements for subsidiaries without public accountability
The IASB proposes to add to IFRS 19 *Subsidiaries without Public Accountability: Disclosures* a requirement to disclose the discount rate (or rates) used in measuring a provision, but not to add a requirement to disclose the approach used to determine that rate (or those rates) (Appendix B). Paragraphs BC101–BC105 of the Basis for Conclusions explain the IASB's reasoning for this proposal. Do you agree with this proposal? Why or why not? If you disagree, which proposal do you disagree with and what would you suggest instead?

Question 6—*Guidance on implementing IAS 37*
The IASB proposes amendments to the *Guidance on implementing IAS 37* Provisions, Contingent Liabilities and Contingent Assets. It proposes: (a) to expand the decision tree in Section B; (b) to update the analysis in the illustrative examples in Section C; and (c) to add illustrative examples to Section C. Paragraphs BC55–BC62 of the Basis for Conclusions explain the IASB's reasoning for these proposals. Do you think the proposed decision tree and examples are helpful in illustrating the application of the requirements? If not, why not? Do you have any other comments on the proposed decision tree or illustrative examples?

Question 7—Other comments
Do you have comments on any other aspects of the proposals in the Exposure Draft?

Deadline

The IASB will consider all comments received in writing by 12 March 2025.

How to comment

Please submit your comments electronically:

Online	https://www.ifrs.org/projects/open-for-comment/
By email	commentletters@ifrs.org

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We normally grant such requests only if they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data. If you would like to request confidentiality, please contact us at commentletters@ifrs.org before submitting your letter.

[Draft] Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Paragraphs 14A–14U, 40A, 47A, 80A, 94B–94E and 106–108 are added, along with the example below paragraph 14P and the headings above paragraphs 14B, 14I, 14M, 14S, 15, 40A and 108. Paragraphs 17–22, the heading above paragraph 17 and the footnote to paragraph 10 are deleted. Paragraphs 3, 10, 14, 15–16, 47, 72–77, 79–80, 81 and 85 are amended, along with the heading below paragraph 14. Paragraphs 1, 36, 42–46, 70–71 and 78 are not amended, but are included for ease of reference. New text is underlined, deleted text is struck through and paragraphs that are not amended but are included for ease of reference are shown in grey.

Scope

1 **This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:**

(a) **those resulting from executory contracts, except where the contract is onerous; and**

(b) [deleted]

(c) **those covered by another Standard.**

...

3 An executory contract is a contract, or a portion of a contract, that is equally unperformed—~~Executory contracts are contracts under which~~ neither party has fulfilled ~~performed~~ any of its obligations~~,~~ or both parties have partially fulfilled ~~performed~~ their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

Definitions

10 **The following terms are used in this Standard with the meanings specified:**

A *provision* is a liability of uncertain timing or amount.

A *liability* is a present obligation of the entity to transfer an economic resource as a result of ~~arising from~~ past events~~, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits~~.~~[1]~~

~~**An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.**~~

A *legal obligation* is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

1 ~~The definition of a liability in this Standard was not revised following the revision of the definition of a liability in the *Conceptual Framework for Financial Reporting* issued in 2018.~~

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(b) legislation; or

(c) other operation of law.

A *constructive obligation* is an obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

...

Recognition

Provisions

14 **A *provision* shall be recognised when three criteria are met:**

(a) an entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event (paragraphs 14A–16);

(b) it is probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation (paragraphs 23–24); and

(c) a reliable estimate can be made of the amount of the obligation (paragraphs 25–26).

If any of these criteria ~~conditions~~ are not met, no provision shall be recognised.

Present obligation recognition criterion

14A The first criterion for recognising a provision (paragraph 14(a)) is that an entity has a present obligation (legal or constructive) to transfer an economic resource as a result of a past event. This criterion (the present obligation recognition criterion) comprises three conditions:

(a) an obligation condition—the entity has an obligation (paragraphs 14B–14H);

(b) a transfer condition—the nature of the entity's obligation is to transfer an economic resource (paragraphs 14I–14L); and

(c) a past-event condition—the entity's obligation is a present obligation that exists as a result of a past event (paragraphs 14M–14U).

Obligation condition (paragraph 14A(a))

14B The first condition for meeting the present obligation recognition criterion is that the entity has an obligation. An entity has an obligation if:

(a) a mechanism is in place that imposes a responsibility on the entity if it obtains specific economic benefits or takes a specific action;

(b) the entity owes that responsibility to another party; and

(c) the entity has no practical ability to avoid discharging the responsibility if it obtains the specific economic benefits or takes the specific action.

14C The mechanism imposing a responsibility could be:

(a) legal—a contract (through its explicit or implicit terms), legislation or other operation of law; or

(b) constructive—the entity's established pattern of past practice, its published policies or a sufficiently specific current statement.

14D The economic benefits the entity obtains could be, for example, cash, goods or services. The action the entity takes could be, for example, operating in a specific market, causing environmental damage or other harm to another party, owning specific assets on a specific date, or constructing an asset that will need to be decommissioned at the end of its useful life.

14E [Derives from first part of former paragraph 20] An obligation is always owed to another party. It is not necessary for an entity to know the identity of the party to whom the obligation is owed. The other party could be a person or another entity, a group of people or other entities, or society at large.

14F An entity has no practical ability to avoid discharging a responsibility:

(a) in the case of a legal obligation, if:

(i) the other party has a legal right to act against the entity if the entity fails to discharge the responsibility—for example, to ask a court to enforce settlement, charge the entity a financial penalty or restrict the entity's access to economic benefits; and

(ii) as a result of that right, the economic consequences for the entity of not discharging the responsibility are expected to be significantly worse than the costs of discharging it; or

(b) in the case of a constructive obligation, if the entity's pattern of past practice, published policy or sufficiently specific current statement creates valid expectations in other parties that the entity will discharge the responsibility.

14G [Derives from former paragraph 22] If details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. In this Standard, such an obligation is treated as a legal obligation. Variations in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

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14H [Derives from second part of former paragraph 20] An obligation requires an entity to have no practical ability to avoid discharging a responsibility. Therefore, a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to create a valid expectation in those affected that the entity will discharge its responsibility.

Transfer condition (paragraph 14A(b))

14I The second condition for meeting the present obligation recognition criterion is that the nature of the entity's obligation is to transfer an economic resource. To meet this condition, the obligation must have the potential to require the entity to transfer an economic resource to another party.

14J For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource—the transfer may, for example, be required only if a specified uncertain future event occurs.

14K Consequently, the probability of a transfer does not affect whether an obligation meets the present obligation recognition criterion—an obligation can meet that criterion even if the probability is low. However, the probability of a transfer could affect:

(a) whether the obligation meets one of the other criteria for recognising a provision—a provision is recognised only if it is probable (more likely than not) that the entity will be required to transfer an economic resource to settle the obligation (see paragraphs 14(b) and 23); and

(b) whether the entity discloses a contingent liability if the obligation does not meet all the criteria for recognising a provision (see paragraph 23).

14L An obligation to exchange economic resources with another party is not an obligation to transfer an economic resource to that party unless the terms of the exchange are unfavourable to the entity. Accordingly, the obligations arising under an executory contract—for example, a contract to receive goods in exchange for paying cash—are not obligations to transfer an economic resource unless the contract is onerous.

Past-event condition (paragraph 14A(c))

14M The third condition for meeting the present obligation recognition criterion is that the entity's obligation is a present obligation that exists as a result of a past event.

14N An entity's obligation becomes a present obligation that exists as a result of a past event when the entity:

(a) has obtained specific economic benefits or taken a specific action, as described in paragraphs 14B and 14D; and

(b) as a consequence of having obtained those benefits or taken that action, will or may have to transfer an economic resource it would not otherwise have had to transfer.

14O If the economic benefits are obtained, or the action is taken, over time, the past-event condition is met, and the resulting present obligation accumulates, over that time.

14P In some situations, an entity has an obligation to transfer an economic resource only if a measure of its activity in a period (the assessment period) exceeds a specific threshold. In such situations, the action that meets the past-event condition is the activity that contributes to the total activity on which the amount of the transfer is assessed. At any date within the assessment period, the present obligation is a portion of the total expected obligation for the assessment period. It is the portion attributable to the activity carried out to date. The entity recognises a provision if the recognition criteria in paragraphs 14(b) and 14(c) are met—that is, if:

(a) it is probable that the entity's activity will exceed the threshold and the entity will be required to transfer an economic resource (see paragraph 14(b)); and

(b) a reliable estimate can be made of the amount of the obligation (see paragraph 14(c)).

Example
Legislation imposes on an entity a responsibility to pay a levy of two per cent of the revenue it generates above a specific threshold in a calendar year. Management judges that this responsibility meets both the obligation condition (paragraph 14A(a)) and the transfer condition (paragraph 14A(b)). The action that meets the past-event condition (paragraph 14A(c)) is generating revenue in the calendar year. Accordingly, a present obligation accumulates as the entity generates that revenue. At any date within the calendar year, the present obligation is the portion of the total expected obligation for the year attributable to the revenue generated to date. The entity recognises a provision if: (a) it is probable that the entity's revenue will exceed the threshold and the entity will be required to pay the levy (see paragraph 14(b)); and (b) a reliable estimate can be made of the amount of the obligation (see paragraph 14(c)).

14Q In some situations, an entity has an obligation to transfer an economic resource only if it takes two (or more) separate actions, and the requirement to transfer an economic resource is a consequence of taking both (or all) these actions. In such situations, the past-event condition is met when the entity has taken the first action (or any of the actions) and has no practical ability to avoid taking the second action (or all the remaining actions).

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14R A decision to prepare an entity's financial statements on a going concern basis implies that the entity has no practical ability to avoid taking an action it could avoid only by liquidating the entity or by ceasing to trade.

Interactions between the obligation and past-event conditions

14S The enactment of a new law is not in itself sufficient to create a present legal obligation for an entity. A present legal obligation arises only if, as a consequence of obtaining the economic benefits or of taking the action to which the law applies, the entity will or may have to transfer an economic resource it would not otherwise have had to transfer (see paragraph 14N).

14T Similarly, having an established pattern of past practice, publishing a policy or making a statement is not in itself sufficient to create a present constructive obligation for an entity. A present constructive obligation arises only if, as a consequence of obtaining the economic benefits or of taking the action to which the practice, policy or statement applies, the entity will or may have to transfer an economic resource it would not otherwise have had to transfer (see paragraph 14N).

14U [Derives from former paragraph 21] An action of the entity that does not give rise to a present obligation immediately might do so at a later date, because a mechanism is introduced that imposes new responsibilities on the entity—a new law might be enacted, an existing law might be changed or the entity might establish a pattern of practice, publish a policy or make a statement that gives rise to a constructive obligation. For example, if an entity causes environmental damage, it might have no obligation to remedy the damage at the time of causing it. However, the causing of the damage will be the past event that has created a present obligation if, at a later date, a new law requires the existing damage to be rectified, or if the entity accepts responsibility for rectification in a way that creates a constructive obligation.

Uncertainty about whether the present obligation recognition criterion is met

15 **In rare cases it is not clear whether there is a present obligation to transfer an economic resource as a result of a past event. In these cases, such an obligation is deemed to exist ~~a past event is deemed to give rise to a present obligation~~ if, taking account of all available evidence, it is more likely than not that the ~~a present~~ obligation exists at the end of the reporting period.**

16 In almost all cases it will be clear whether a past event has given rise to a present obligation to transfer an economic resource. In rare cases, it is not clear—for example in a lawsuit, it may be disputed either whether specific ~~certain~~ events have occurred or whether those events result in a present obligation to transfer an economic resource. In such a case, an entity determines whether such an ~~a present~~ obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

(a) where it is more likely than not that a present obligation to transfer an economic resource exists as a result of a past event at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no such ~~present~~ obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of the entity being required to transfer an economic resource ~~an outflow of resources embodying economic benefits~~ is remote (see paragraph 86).

~~Past event~~

17–22 [Deleted]

~~17~~ [Replaced by paragraph 14F] ~~A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:~~

~~(a) where the settlement of the obligation can be enforced by law; or~~

~~(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.~~

~~18~~ ~~Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the end of the reporting period.~~

~~19~~ [Replaced by paragraphs 14N–14R] ~~It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.~~

~~20~~ [Renumbered as paragraphs 14E and 14H with edits] ~~An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management~~

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~~or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.~~

~~21~~ [Renumbered as paragraph 14U with edits] ~~An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.~~

~~22~~ [Renumbered as paragraph 14G] ~~Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.~~

...

Measurement

Best estimate

36 **The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.**

...

Costs to include

40A The expenditure required to settle an obligation comprises the costs that relate directly to the obligation. Costs that relate directly to an obligation consist of both:

(a) the incremental costs of settling that obligation; and

(b) an allocation of other costs that relate directly to settling obligations of that type.

...

Risks and uncertainties

42 **The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.**

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

Present value

45 **Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.**

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

47 **The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s):**

(a) **current market assessments of the time value of money, represented by a risk-free rate; and**

(b) **risks surrounding the amount or timing of the expenditure required to settle the obligation (as described in paragraphs 42–43) if those risks are not reflected in the estimates of the future cash flows ~~the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted~~.**

47A The discount rate (or rates) does (do) not reflect non-performance risk—the risk that the entity will not settle the obligation.

...

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Application of the recognition and measurement rules

...

Restructuring

70 The following are examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

(b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;

(c) changes in management structure, for example, eliminating a layer of management; and

(d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

71 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 14 are met. Paragraphs 72–83 set out how the general recognition criteria apply to restructurings.

72 A present ~~constructive~~ obligation for the costs of a restructuring ~~to restructure~~ arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditures that will be undertaken; and

(v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

73 Evidence that an entity has started to implement a restructuring plan would be provided, for example, by:

(a) dismantling plant or selling assets; or

(b) ~~by~~ the public announcement of the plan, ~~the main features of the plan. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only~~ if it is made in such a way and in sufficient detail (ie setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the entity will carry out the restructuring.

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74 For a plan ~~to be sufficient~~ to give rise to such expectations ~~to a constructive obligation when communicated to those affected by it~~, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to restructuring, because the timeframe allows opportunities for the entity to change its plans.

75 A management or board decision to restructure taken before the end of the reporting period does not give rise to a present ~~constructive~~ obligation at the end of the reporting period unless the entity has, before the end of the reporting period:

(a) started to implement the restructuring plan; or

(b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under IAS 10 *Events after the Reporting Period*, if information about the restructuring is material and non-disclosure could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

76 Although a present ~~constructive~~ obligation is not created solely by a management decision, a present ~~an~~ obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the entity has a present ~~constructive~~ obligation for restructuring costs ~~to restructure~~, if the conditions of paragraph 72 are met.

77 In some countries, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (eg employees) or notification to such representatives may be necessary before the board decision is taken. Because a decision by such a board involves communication to these representatives, it may result in a present ~~constructive~~ obligation for restructuring costs ~~to restructure~~.

78 **No obligation arises for the sale of an operation until the entity is committed to the sale, ie there is a binding sale agreement.**

79 Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on

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acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under IAS 36. When a sale is only part of a restructuring, a present ~~constructive~~ obligation can arise for the costs of the other parts of the restructuring before a binding sale agreement exists.

80 **A restructuring provision shall include only present obligations for the direct expenditures arising from the restructuring, which are those that are both:**

(a) **necessarily entailed by the restructuring; and**

(b) **not associated with the ongoing activities of the entity.**

80A A restructuring provision could include such obligations as:

(a) statutory, contractual or constructive obligations to pay termination benefits to employees whose roles are made redundant by the restructuring, to the extent that the obligations relate to past employment; or

(b) contractual obligations to pay penalties for cancelling executory supply contracts the entity entered into before the end of the reporting period.

81 A restructuring provision does not include such costs as:

(a) retraining or relocating continuing staff;

(b) marketing; or

(c) investment in new systems and distribution networks.

These expenditures relate to the future conduct of the business and are not present obligations to transfer an economic resource ~~liabilities for restructuring~~ at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

...

Disclosure

...

85 **An entity shall disclose the following for each class of provision:**

(a) **a brief description of the nature of the obligation and the expected timing of any resulting transfer ~~outflows~~ of economic resources ~~benefits~~;**

(b) **an indication of the uncertainties about the amount or timing of that transfer ~~those outflows~~. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48;~~ and~~**

(c) **the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement; and.**

(d) **if a provision is discounted, the discount rate (or rates) used in measuring the provision and the approach used to determine that rate (or those rates).**

...

Transitional provisions

...

94B *Provisions—Targeted Improvements*, issued in [Month, Year], amended IAS 37 (see paragraph 106). An entity shall apply those amendments retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (see paragraph 94C), except as required by paragraph 94D and as permitted by paragraph 94E. For the purposes of applying paragraphs 94C–94E:

(a) the transition date is the beginning of the first annual reporting period for which the entity provides comparative information; and

(b) the date of initial application is the beginning of the annual reporting period in which the entity first applies the amendments.

94C To apply the amendments described in paragraph 94B retrospectively, an entity shall at the transition date:

(a) identify, recognise and measure provisions as if the entity had always applied the amendments;

(b) re-measure the carrying amount of related assets (for example, items of property, plant and equipment or right-of-use assets), if any, as if the entity had always applied the amendments; and

(c) recognise any resulting net difference in retained earnings or other component of equity, as appropriate.

94D If an entity changes its accounting policy for the costs it includes in the measure of a provision to comply with paragraph 40A, the entity shall apply the change in accounting policy:

(a) only to obligations the entity has not yet settled at the date of initial application; and

(b) without restating comparative information. Instead, the entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of a related asset (if any), retained earnings or other component of equity, as appropriate, at the date of initial application.

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94E If an entity changes its accounting policy for determining discount rates to comply with the amendments to paragraphs 47–47A, the entity is not required to comply with the requirements in IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* for changes in the measurement of a provision that occurred before the transition date. An entity that uses this exemption shall:

(a) apply the amended requirements to restate the provision at the transition date; and

(b) apportion the amount by which it adjusts the provision at the transition date between the related asset and retained earnings:

(i) assuming the current discount rate(s) and estimates of cash flows used in measuring the provision have not changed since the provision was first recognised; and

(ii) using current estimates of the useful life of the related asset.

Effective date

...

106 *Provisions—Targeted Improvements*, issued in [Month, Year]:

(a) added paragraphs 14A–14U, 40A, 47A, 80A, 94B–94E and 106–108;

(b) deleted paragraphs 17–22; and

(c) amended paragraphs 3, 10, 14, 15–16, 47, 72–77, 79–80, 81 and 85.

107 An entity shall apply the amendments listed in paragraph 106 for annual reporting periods beginning on or after [Day, Month, Year]. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Withdrawal of IFRIC 6 and IFRIC 21

108 *Provisions—Targeted Improvements*, issued in [Month, Year], supersedes IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*.

Appendix A—[Draft] Minor amendments to IAS 37

This appendix lists [draft] minor amendments to other paragraphs in IAS 37 that include words or phrases from the definition of a liability in paragraph 10.

Paragraphs 10, 13, 23–24, 28–30, 39, 59 and 86 and the subheading before paragraph 23 are amended. New text is underlined and deleted text is struck through.

Definitions

10 **The following terms are used in this Standard with the meanings specified:**

...

A *contingent liability* is:

...

(b) **a present obligation that arises from past events but is not recognised because:**

(i) **it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation; or**

(ii) **the amount of the obligation cannot be measured with sufficient reliability.**

...

Relationship between provisions and contingent liabilities

...

13 This Standard distinguishes between:

(a) provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer economic resources to settle the obligations; and

(b) contingent liabilities – which are not recognised as liabilities because they are either:

(i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to the transfer of an economic resource ~~an outflow of resources embodying economic benefits~~; or

(ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the

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obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

...

Recognition

Provisions

...

Probable transfer of an economic resource ~~outflow of resources embodying economic benefits~~

23 For a liability to qualify for recognition there must be not only a present obligation but also the probability of the entity transferring an economic resource ~~an outflow of resources embodying economic benefits~~ to settle that obligation. For the purpose of this Standard,[footnote not included] a transfer of an economic resource ~~an outflow of resources~~ or other event is regarded as probable if the event is more likely than not to occur, ie the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of the entity transferring an economic resource ~~an outflow of resources embodying economic benefits~~ is remote (see paragraph 86).

24 Where there are a number of similar obligations (eg product warranties or similar contracts) the probability that a transfer ~~an outflow~~ will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of a transfer ~~outflow~~ for any one item may be small, it may well be probable that some transfers ~~outflow of resources~~ will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

...

Contingent liabilities

...

28 A contingent liability is disclosed, as required by paragraph 86, unless the possibility of a transfer of an economic resource ~~an outflow of resources embodying economic benefits~~ is remote.

29 Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which a transfer of an economic resource ~~an outflow of resources embodying economic benefits~~ is probable, except in the extremely rare circumstances where no reliable estimate can be made.

30 Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether a transfer of an economic resource ~~an outflow of resources embodying economic benefits~~ has become probable. If it becomes probable that the entity ~~an outflow of future economic benefits~~ will be required to transfer an economic resource for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

...

Measurement

Best estimate

...

39 ...

Example

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of 1 million would result. If major defects were detected in all products sold, repair costs of 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75 per cent of the goods sold will have no defects, 20 per cent of the goods sold will have minor defects and 5 per cent of the goods sold will have major defects. In accordance with paragraph 24, an entity assesses the probability of repair costs ~~an outflow~~ for the warranty obligations as a whole.

The expected value of the cost of repairs is:

(75% of nil) + (20% of 1m) + (5% of 4m) = 400,000

...

Changes in provisions

59 **Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation, the provision shall be reversed.**

...

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Disclosure

...

86 Unless the possibility of any transfer of economic resources ~~outflow~~ in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 36–52;

(b) an indication of the uncertainties relating to the amount or timing of any transfer ~~outflow~~; and

(c) the possibility of any reimbursement.

Appendix B—[Draft] Amendments to other IFRS Accounting Standards

This appendix sets out the [draft] amendments to other IFRS Accounting Standards proposed as a consequence of the proposed amendments to IAS 37.

IFRS 3 *Business Combinations*

Paragraphs 21, 22 and 23 and the subheading after paragraph 21 are amended. Paragraphs 21A–21C and the subheading before paragraph 21A are deleted. Paragraph 64S is added. New text is underlined and deleted text is struck through.

The acquisition method

...

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

...

Exceptions to the recognition or measurement principles

21 This IFRS provides limited exceptions to its recognition and measurement principles. Paragraphs 22 ~~21A~~–31A specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 22 ~~21A~~–31A, which will result in some items being:

(a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other IFRSs, with results that differ from applying the recognition principle and conditions.

(b) measured at an amount other than their acquisition-date fair values.

Exception ~~Exceptions~~ to the recognition principle

~~**Liabilities and contingent liabilities within the scope of IAS 37 or IFRIC 21**~~

21A–21C [Deleted]

~~21A~~ ~~Paragraph 21B applies to liabilities and contingent liabilities that would be within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRIC 21 *Levies* if they were incurred separately rather than assumed in a business combination.~~

~~21B~~ ~~The *Conceptual Framework for Financial Reporting* defines a liability as 'a present obligation of the entity to transfer an economic resource as a result of past events'. For a provision or contingent liability that would be within the scope of IAS 37, the acquirer shall apply paragraphs 15–22 of IAS 37 to determine whether at the acquisition date a present obligation exists as a result of past~~

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~~events. For a levy that would be within the scope of IFRIC 21, the acquirer shall apply IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.~~

~~21C~~ ~~A present obligation identified in accordance with paragraph 21B might meet the definition of a contingent liability set out in paragraph 22(b). If so, paragraph 23 applies to that contingent liability.~~

Contingent liabilities and contingent assets

22 IAS 37 defines a contingent liability as:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

23 The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to paragraphs 14(b), 23, 27, 29 and 30 of IAS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that the entity ~~an outflow of resources embodying economic benefits~~ will be required to transfer an economic resource to settle the obligation. Paragraph 56 of this IFRS provides guidance on the subsequent accounting for contingent liabilities.

...

Effective date and transition

Effective date

...

64S *Provisions—Targeted Improvements*, issued in [Month, Year], which amended IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, also amended paragraphs 21, 22 and 23 of this Standard and deleted paragraphs 21A–21C. An entity shall apply the amendments to this Standard when it applies the amendments to IAS 37.

IFRS 19 *Subsidiaries without Public Accountability: Disclosures*

Paragraphs 258 and 259 are amended and paragraph A6 is added. New text is underlined and deleted text is struck through.

Disclosure requirements

...

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

...

258 An entity shall also disclose, for each class of provision (comparative information is not required):

(a) a brief description of the nature of the obligation and the expected timing of any resulting transfer ~~outflows~~ of economic resources ~~benefits~~.

(b) an indication of the uncertainties about the amount or timing of that transfer ~~those outflows~~. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48 of IAS 37.

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

(d) if a provision is discounted, the discount rate (or rates) used in measuring the provision.

259 Unless the possibility of any transfer of economic resources ~~outflow~~ in settlement is remote, an entity shall disclose, for each class of contingent liability at the end of the reporting period, a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 36–52 of IAS 37;

(b) an indication of the uncertainties relating to the amount or timing of any transfer ~~outflow~~; and

(c) the possibility of any reimbursement.

...

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Appendix A—Effective date and transition

...

Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

A6 *Provisions—Targeted Improvements*, issued in [Month, Year], amended IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and paragraphs 258 and 259 of this Standard. An entity shall apply the amendments to paragraphs 258 and 259 when it applies the amendments to IAS 37.

Other consequential amendments

Table B1 lists paragraphs of other IFRS Accounting Standards and accompanying guidance for which minor consequential amendments would be required to align the wording of references to IAS 37 with the revised wording in IAS 37.

Table B1—Other consequential amendments

Type of amendment	IFRS Accounting Standard or guidance	Paragraphs
Updated references to requirements in IAS 37 to maintain consistency with the amended wording of the definition of a liability and recognition criteria in IAS 37.	*Illustrative Examples on IAS 34* Interim Financial Reporting	B3–B4
	IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*	3–4
Updated wording of references to the IAS 37 requirements on discount rates.	IFRS 1 *First-time Adoption of International Financial Reporting Standards*	D21(b)
	Guidance on implementing IFRS 1 First-time Adoption of International Financial Reporting Standards	IG Example 201 (after paragraph IG203)
	IFRIC 1	3–4

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The Exposure Draft *Provisions—Targeted Improvements* was approved for publication by all 14 members of the International Accounting Standards Board.

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November 2024

Exposure Draft

IFRS® Accounting Standard

Provisions—Targeted Improvements

Proposed amendments to

Guidance on implementing IAS 37

Comments to be received by 12 March 2025

International Accounting Standards Board

IASB/ED/2024/8

Exposure Draft
Provisions—Targeted Improvements

Proposed amendments to
Guidance on implementing IAS 37

Comments to be received by 12 March 2025

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IMPLEMENTATION GUIDANCE

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Guidance on implementing IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

This guidance accompanies, but is not part of, IAS 37. All paragraph references in this guidance are to paragraphs in IAS 37.

Sections A, B and C are amended as described in each section. Section D is unamended and not reproduced in this exposure draft.

A Tables—Provisions, contingent liabilities, contingent assets and reimbursements

Minor amendments are made to the wording in the tables in Section A, for consistency with amendments to the definition of a liability in IAS 37. These minor amendments are not shown in this exposure draft.

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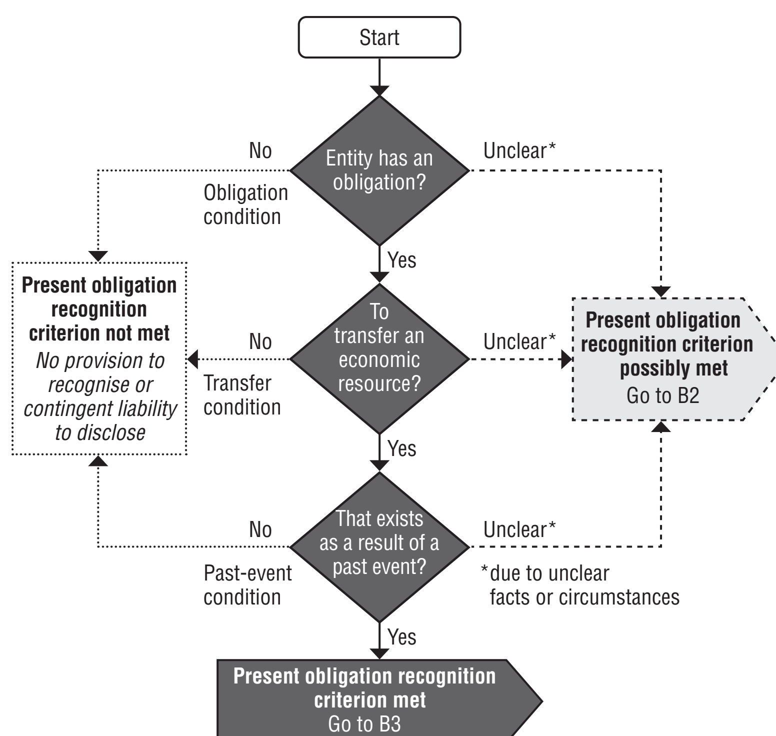
B Decision tree

The decision tree and supporting explanation are deleted and a new three-part decision tree and supporting explanation are added. For ease of reading, the changes to the decision tree are not marked. Other new text is underlined and other deleted text is struck through.

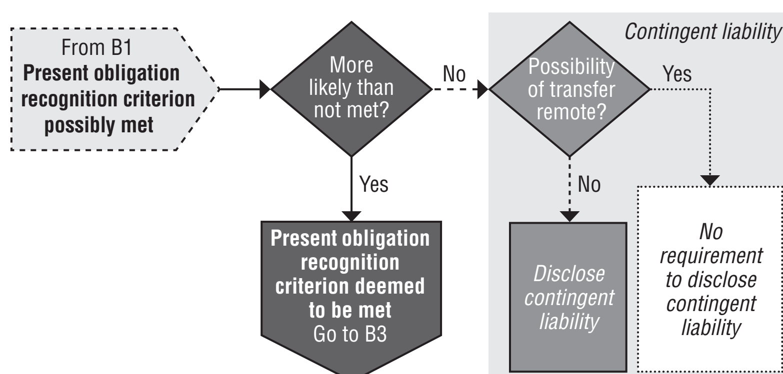
This three-part decision tree summarises the process of applying the three criteria for recognising a provision set out in paragraphs 14–26.~~The purpose of this diagram is to summarise the main recognition requirements of the Standard for provisions and contingent liabilities.~~

B1 Present obligation recognition criterion (paragraphs 14(a) and 14A–16)

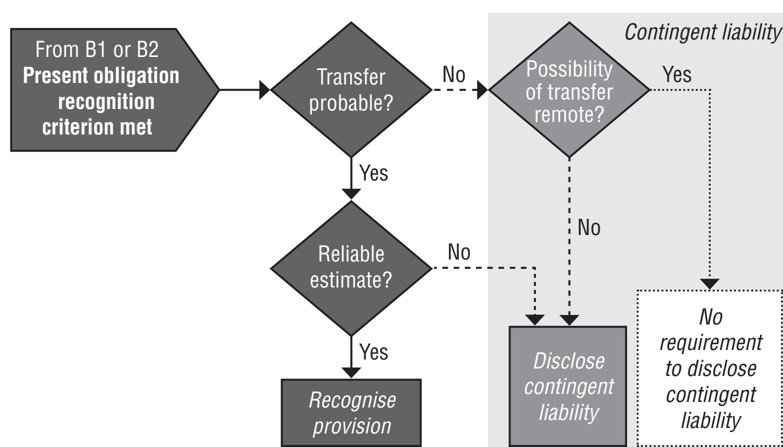


B2 Additional decision needed if it is unclear whether the present obligation recognition criterion is met (paragraphs 15–16)

~~Note:~~ In rare cases, it is not clear whether there is a present obligation to transfer an economic resource as a result of a past event. In these cases, such an obligation is deemed to exist ~~a past event is deemed to give rise to a present obligation~~ if, taking account of all available evidence, it is more likely than not that the ~~a present~~ obligation exists at the end of the reporting period (paragraph 15 ~~of the Standard~~).



B3 Probable transfer and reliable estimate recognition criteria (paragraphs 14(b), 14(c) and 23–26)



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C Examples—Recognition

Example 4 is deleted. Examples 12–15 are added. Examples 1–3, 5A–7 and 10–11B are amended. Examples 8 and 9 were deleted by previous amendments. New text is underlined and deleted text is struck through.

The examples in this section illustrate the application of the recognition requirements in paragraphs 14–26.

All the entities in the examples have financial reporting periods ending on 31 December unless otherwise stated ~~year ends~~. In all cases, it is assumed that a reliable estimate can be made of the amount of any obligation ~~any outflows expected~~. In some examples the circumstances described may have resulted in impairment of the assets—this aspect is not dealt with in the examples.

The cross-references provided in the examples indicate paragraphs of IAS 37 ~~the Standard~~ that are particularly relevant.

References to 'best estimate' are to the present value amount, where the effect of the time value of money is material.

Example 1—Warranties

A manufacturer provides ~~gives~~ warranties in connection with the sale ~~at the time of sale to purchasers~~ of its products. The warranties are provided within the contract for sale of the product (they are not sold separately) and they provide customers with assurance that the product will function as intended. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale.

Management judges that the manufacturer has no practical ability to avoid complying with the terms of the contract for sale. On past experience, management judges it is probable (ie more likely than not) that there will be some claims under the warranties provided on past sales.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.~~

Obligation condition	✓	The contract for sale imposes a responsibility on the manufacturer if it sells defective products (paragraph 14B(a)). The manufacturer owes that responsibility to its customers (paragraph 14B(b)). The manufacturer has no practical ability to avoid discharging its responsibility if it sells defective products (paragraph 14B(c)).
Transfer condition	✓	The obligation has the potential to require the manufacturer to provide repair services or replacement goods to customers (paragraphs 14I–14J).
Past-event condition	✓	On the basis of the available evidence (past experience), management judges it to be more likely than not that the manufacturer has taken the action (selling defective products) as a consequence of which it will have to provide services or goods it would not otherwise have had to provide (paragraphs 14N and 15–16). The past-event condition is met for warranty costs attributable to defective products sold in the past.

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable for the warranties as a whole (see paragraph 24).

Conclusion – A provision is recognised for the best estimate of the costs of repairing or replacing ~~making good~~ under the warranty products sold before the end of the reporting period ~~(see paragraphs 14 and 24)~~.

Example 2A—Contaminated land: legislation virtually certain to be enacted

An entity in the oil industry causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At 31 December 20X0 it is virtually

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certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year-end. Management judges that, the entity will have no practical ability to avoid complying with the law.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.~~

Obligation condition	✓	An obligation arises when legislation is virtually certain to be enacted as drafted (paragraph 14G). Legislation that is virtually certain to be enacted imposes a responsibility on the entity if it contaminates land (paragraph 14B(a)). The entity owes that responsibility to the country's government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it contaminates land (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to provide clean-up services (paragraph 14I).
Past-event condition	✓	The entity has taken the action (contaminating land) as a consequence of which it will have to provide clean-up services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for clean-up costs attributable to contamination caused before the end of the reporting period.

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable.

Conclusion – A provision is recognised at 31 December 20X0 for the best estimate of the costs of cleaning up contamination caused before that date ~~the clean-up (see paragraphs 14 and 22)~~.

Example 2B—Contaminated land and constructive obligation

An entity in the oil industry causes contamination and operates in a country where there is no environmental legislation. However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy. Management judges that by publishing the policy and honouring it in the past, the entity has created a valid expectation in society at large that it will honour the policy in the future and therefore has no practical ability to avoid doing so. The entity has contaminated land and has not yet cleaned it up.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.~~

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Obligation condition	✓	The entity's published policy imposes a responsibility on the entity if it contaminates land (paragraph 14B(a)). The entity owes that responsibility to the country's government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it contaminates land (paragraphs 14B(c) and 14F(b)).
Transfer condition	✓	The entity's obligation is to provide clean-up services (paragraph 14I).
Past-event condition	✓	The entity has taken the action (contaminating land) as a consequence of which it will have to provide clean-up services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for clean-up costs attributable to contamination caused before the end of the reporting period.

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of the costs of cleaning up contamination caused before the end of the reporting period ~~clean-up (see paragraphs 10 (the definition of a constructive obligation), 14 and 17)~~.

Example 3—Offshore oilfield

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Management judges that the entity has no practical ability to avoid complying with the terms of the licensing agreement.

Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of the area damaged by constructing ~~damage caused by building~~ it, and 10% ~~per cent~~ arise through the extraction of oil. At the end of the reporting period, the oil rig has been constructed but no oil has been extracted.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The construction of the oil rig creates a legal obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the end of the reporting period, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.~~

Obligation condition	✓	The licensing agreement imposes a responsibility on the entity if it constructs an oil rig (paragraph 14B(a)). The entity owes that responsibility to the licensor (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it constructs an oil rig (paragraph 14B(c)).

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Transfer condition	✓	The entity's obligation is to provide oil rig removal and seabed restoration services (paragraph 14I).
Past-event condition	✓	The entity has taken the action (constructing the oil rig) as a consequence of which it will have to provide oil rig removal and seabed restoration services it would not otherwise have had to provide (paragraph 14N). The past-event condition is met for the portion of the total expected costs attributable to removing the oil rig and rectifying damage caused to date (90% of the total expected costs) (paragraph 14O). The entity will incur further costs (10% of the total) as a consequence of extracting oil. The entity has not yet extracted oil, so the past-event condition is not yet met for those further costs (paragraph 14O).

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of 90% ~~ninety per cent~~ of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by constructing ~~building~~ it ~~(see paragraph 14)~~. To comply with the requirements in IAS 16 *Property, Plant and Equipment*, these ~~These~~ costs are included as part of the cost of the oil rig. A provision for the 10% ~~The 10 per cent~~ of costs that arise through the extraction of oil will be ~~are~~ recognised ~~as a liability~~ when the oil is extracted.

Example 4—Refunds policy

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~~A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.~~

~~**Present obligation as a result of a past obligating event** – The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.~~

~~**An outflow of resources embodying economic benefits in settlement** – Probable, a proportion of goods are returned for refund (see paragraph 24).~~

~~**Conclusion** – A provision is recognised for the best estimate of the costs of refunds (see paragraphs 10 (the definition of a constructive obligation), 14, 17 and 24).~~

Example 5A—Closure of a division: no communication or implementation before end of the reporting period

On 12 December 20X0 the board of an entity decided to close down a division. Closing the division will necessarily entail terminating employee contracts. Employees who have provided at least one year's service will have a contractual right to receive termination benefits (redundancy payments). Management judges that the entity has no practical ability to avoid its contractual obligations.

Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: There has been no obligating event and so there is no obligation.

Obligation condition	✓	The entity's contracts with its employees impose a responsibility on the entity if it takes two actions—employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14B(a)). The entity owes that responsibility to its employees (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions—closing the division will necessarily entail paying employee termination benefits (paragraphs 14B(c) and 80(a)).
Transfer condition	✓	The entity's obligation is to pay termination benefits to its employees (paragraph 14I).
Past-event condition	✗	The entity is required to pay employee termination benefits only if it takes two separate actions— employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14Q). At 31 December 20X0 the entity has taken the first action but still has the practical ability to avoid the second action because the criteria set out in paragraph 72 are not met—the entity has not yet started to implement a closure plan or announced the main features of a closure plan to affected employees.

Conclusion – No provision is recognised at 31 December 20X0 (see paragraphs 14 and 72).

Example 5B—Closure of a division: communication/implementation before end of the reporting period

On 12 December 20X0 the board of an entity decided to close down a division making a particular product. Closing the division will necessarily entail terminating employee and customer contracts. Employees who have provided at least one year's service will have a contractual right to receive termination benefits (redundancy payments) and some customers will have a contractual right to receive contract termination penalties.

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Management judges that the entity has no practical ability to avoid its contractual obligations.

On 20 December 20X0 the board agreed a detailed plan for closing ~~down~~ the division, ~~was agreed by the board;~~ letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the staff of the division.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met: ~~The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.~~

Obligation condition	✓	The entity's contracts with its employees impose a responsibility on the entity if it takes two actions—employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14B(a)). The entity owes that responsibility to its employees (paragraph 14B(b)). Similarly, the entity's contracts with some of its customers impose a responsibility on the entity if it takes two actions—entering into the contract with the customer and then terminating the contract. The entity owes that responsibility to its customers. The entity has no practical ability to avoid discharging its responsibilities if it takes the two actions—closing the division will necessarily entail paying termination benefits and penalties (paragraphs 14B(c) and 80(a)).
Transfer condition	✓	The entity's obligation is to pay termination benefits to its employees and contract termination penalties to its customers (paragraph 14I).
Past-event condition	✓	The entity is required to pay employee termination benefits only if it takes two separate actions—employing (obtaining services from) a person for at least a year and then terminating the employee's contract (paragraph 14Q). At 31 December 20X0 the entity has taken the first action and has no practical ability to avoid the second action because the criteria set out in paragraph 72 are met—the entity has a detailed formal plan for closing the division and it has sent redundancy notices to affected employees. The termination benefits are payable in respect of past service from employees—they are not associated with the ongoing activities of the entity (paragraph 80(b)). By the same logic, the past-event condition is met for the contract termination penalties payable to customers.

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable.

Conclusion – A provision is recognised at 31 December 20X0 for the best estimate of the costs of employee termination benefits and customer contract termination penalties that will be payable as a result of closing the division ~~(see paragraphs 14 and 72)~~.

Example 6—Legal requirement to fit smoke filters

In 20X0 a government enacts legislation. Under the ~~new~~ legislation, entities that produce smoke in their operations are ~~an entity is~~ required to fit smoke filters to their ~~its~~ factories by 30 June 20X1~~.~~ to protect the health of factory workers. Entities that fail to comply may be subject to fines. An entity that produces smoke in its operations has not started fitting ~~The entity has not fitted the~~ smoke filters by 31 December 20X1.

Management judges that the entity has no practical ability to avoid complying with the terms of the legislation or paying fines that may be charged for non-compliance.

(a) At 31 December 20X0~~, the end of the reporting period~~

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – The three conditions specified in paragraph 14A of IAS 37 are not all met: ~~There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.~~

Obligation condition	✓	The legislation imposes responsibilities on the entity if it produces smoke after 30 June 20X1 (paragraph 14B(a)). The entity owes these responsibilities to the government, which acts on behalf of factory workers (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibilities if it produces smoke after 30 June 20X1 (paragraph 14B(c)).
Transfer condition	✗	**Obligation to fit smoke filters** The obligation to fit smoke filters does not meet the transfer condition. It is an obligation to exchange economic resources, not an obligation to transfer an economic resource (paragraph 14L). In buying and fitting the filters, the entity will pay cash and receive property, plant and equipment in exchange.
	✓	**Obligation to pay fines** The obligation to pay fines meets the transfer condition. It is an obligation that has the potential to require the entity to pay cash (paragraphs 14I–14J).

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Past-event condition	✗	The entity has not yet taken the action (producing smoke after 30 June 20X1) as a consequence of which it will have to fit smoke filters or may have to pay fines it would not otherwise have had to pay (paragraph 14N). The entity has not yet obtained the economic benefits (received the smoke filters) as a consequence of which it will have to pay for the filters (paragraph 14N).

Conclusion – At 31 December 20X0 no ~~No~~ provision is recognised for the costs of either fitting the smoke filters or paying fines ~~(see paragraphs 14 and 17–19)~~.

(b) At 31 December 20X1~~, the end of the reporting period~~

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are now met for the obligation to pay fines, but they are not all met for the obligation to fit smoke filters: ~~There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).~~

Obligation condition	✓	As for part (a).
Transfer condition	✗ ✓	**Obligation to fit smoke filters** As for part (a). **Obligation to pay fines** As for part (a).
Past-event condition	✓	The entity has taken the action (producing smoke after 30 June 20X1) as a consequence of which it will have to fit smoke filters and may have to pay fines it would not otherwise have had to pay (paragraph 14N). However, the entity has still not obtained the economic benefits (received the smoke filters) as a consequence of which it will have to pay for the filters (paragraph 14N).

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – The assessment ~~Assessment~~ of the probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion – At 31 December 20X1 no ~~No~~ provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines ~~and penalties~~ that are more likely than not to be imposed ~~(see paragraphs 14 and 17–19)~~.

Example 7—Staff retraining as a result of changes in the income tax system

A ~~The~~ government has introduced ~~introduces~~ a number of changes to the income tax system that will be effective from 20X2. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales staff ~~workforce in order~~ to ensure continued compliance with financial services regulation in the future. The entity is preparing financial statements for the year ended 31 December 20X0. At the end of the reporting period, no retraining of staff has taken place and the entity has not yet entered into any contracts with training providers.

Management judges that the entity has no practical ability to avoid complying with responsibilities imposed by financial services regulation and by contracts with training providers.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – The three conditions specified in paragraph 14A of IAS 37 are not all met: ~~There is no obligation because no obligating event (retraining) has taken place.~~

Obligation condition	✗	Financial services regulation imposes a responsibility on the entity to provide its services to a specified standard (paragraph 14B(a)). The entity will carry out staff retraining to ensure it continues to provide its services to the specified standard in the future. However, the entity will carry out the retraining for its own benefit, to enable it to keep providing services. It owes no responsibility for retraining to another party (paragraph 14B(b)). A contract with a provider of training services would impose responsibilities on the entity that it would owe to the provider and have no practical ability to avoid discharging (paragraph 14B). However, no such contract yet exists.
Transfer condition	✗	Retraining staff will involve exchanging economic resources, not transferring an economic resource (paragraph 14L). The entity will pay cash to a training provider and receive training services from the provider in exchange.
Past-event condition	✗	The entity has not yet obtained the economic benefits (training services) as a consequence of which it will have to transfer an economic resource (pay the training provider) (paragraph 14N).

Conclusion – No provision is recognised ~~(see paragraphs 14 and 17–19)~~.

Example 8—An onerous contract

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Example 9—A single guarantee

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Example 10—A court case

The law imposes a responsibility on an entity to pay damages if it sells food that poisons consumers. After a wedding in 20X0, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings have are started seeking damages from the entity but it disputes liability. Up to the date when of authorisation of the financial statements for the year to 31 December 20X0 are authorised for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X1, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. Management judges that the entity will have no practical ability to avoid paying damages if it is found liable.

(a) At 31 December 20X0

Present obligation to transfer an economic resource as a result of a past obligating event – The three conditions specified in paragraph 14A of IAS 37 are not all met: On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Obligation condition	✓	The law imposes a responsibility on the entity if it sells food that poisons consumers (paragraph 14B(a)). The entity owes that responsibility to consumers (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it sells food that poisons consumers (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay damages to poisoned consumers (paragraph 14I).
Past-event condition	Unclear	The past-event condition is met if in 20X0 the entity has sold food that poisoned consumers (paragraph 14N). It is unclear whether the entity has done so. Accordingly, paragraphs 15–16 apply. On the basis of the evidence available when the 20X0 financial statements are authorised for issue, management judges it *is not* more likely than not that the entity has sold food that poisoned consumers. It is possible that the entity has a present obligation that arises from a past event. This possible obligation meets the definition of a contingent liability (paragraph 10).

Conclusion – No provision is recognised at 31 December 20X0 (see paragraphs 15 and 16). The matter is disclosed as a contingent liability unless the probability of any transfer outflow is regarded as remote (paragraph 86).

(b) At 31 December 20X1

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – All three conditions specified in paragraph 14A of IAS 37 are met or deemed to be met: ~~On the basis of the evidence available, there is a present obligation.~~

Obligation condition	✓	As for part (a).
Transfer condition	✓	As for part (a).
Past-event condition	Deemed ✓	As for part (a), except that, on the basis of the evidence available when the 20X1 financial statements are authorised for issue, management now judges it *is* more likely than not that the entity has sold food that poisoned consumers. Consequently, the past-event condition is deemed to have been met (paragraphs 15–16).

A transfer of economic resources ~~An outflow of resources embodying economic benefits~~ in settlement – Probable.

Conclusion – A provision is recognised at 31 December 20X1 for the best estimate of the amount to settle the obligation to pay damages for selling food that poisoned consumers ~~(paragraphs 14–16)~~.

Example 11—Repairs and maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. IAS 16 *Property, Plant and Equipment* sets out requirements for ~~gives guidance on~~ allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example 11A—Refurbishment costs: no legislative requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – The three conditions specified in paragraph 14A of IAS 37 are not all met: ~~There is no present obligation.~~

Obligation condition	✗	No mechanism is in place that imposes on the entity a responsibility that it owes to another party (paragraph 14B). The entity will replace the lining in the furnace for its own benefit.
Transfer condition	✗	Replacing a furnace lining will involve exchanging economic resources, not transferring an economic resource (paragraph 14L). The entity will pay cash and receive a new lining in exchange.

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Past-event condition	✗	The entity has not yet obtained the economic benefits (the replacement lining) as a consequence of which it will have to transfer an economic resource (pay the lining supplier) (paragraph 14N).

Conclusion – No provision is recognised ~~(see paragraphs 14 and 17–19)~~.

~~The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions—even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.~~ Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, ie it is depreciated over five years. The re-lining costs then incurred are added to the cost of the furnace, ~~capitalised~~ with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 11B—Refurbishment costs: legislative requirement

An airline is required by law to overhaul its aircraft once every three years. It is two years since the airline last overhauled its aircraft. Management judges that the airline has no practical ability to avoid complying with the law.

Present obligation to transfer an economic resource as a result of a past ~~obligating~~ event – The three conditions specified in paragraph 14A of IAS 37 are not all met: ~~There is no present obligation.~~

Obligation condition	✓	A law imposes a responsibility on the airline if it operates aircraft that has not been overhauled for more than three years (paragraph 14B(a)). The airline owes this responsibility to its passengers and to society at large (paragraph 14B(b)). The airline has no practical ability to avoid discharging its responsibility if it operates aircraft that has not been overhauled for more than three years (paragraph 14B(c)).
Transfer condition	✗	The obligation to overhaul aircraft is an obligation to exchange economic resources, not an obligation to transfer an economic resource (paragraph 14L). In overhauling the aircraft, the entity will pay cash in exchange for enhancing the future economic benefits embodied in the aircraft.
Past-event condition	✗	The entity has not yet taken the action (operating aircraft that has not been overhauled for more than three years) as a consequence of which it will have to overhaul aircraft (paragraph 14N). The entity has not yet obtained the economic benefits (aircraft overhaul services) as a consequence of which it will have to pay for the overhaul (paragraph 14N).

Conclusion – No provision is recognised ~~(see paragraphs 14 and 17–19)~~.

~~The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions—the entity could avoid the future expenditure by its future actions, for example by selling the aircraft.~~ Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, ie an amount equivalent to the expected maintenance costs is depreciated over three years.

Example 12—Liabilities arising from participating in a specific market: waste electrical and electronic equipment

In 20X3 a country enacts legislation requiring entities that manufacture and sell specified types of electrical and electronic equipment (specified equipment) in that country to contribute to the costs of disposal of the equipment at the end of its life. One section of the legislation applies to equipment sold before the legislation was enacted (historical equipment). It specifies that the disposal costs for historical equipment will be borne by entities selling specified equipment in 20X5. Costs will be allocated to each entity in proportion to its share of the country's market for specified equipment that year—regardless of whether the entity sold any of the historical equipment, or how much it sold.

An entity that manufactured and sold historical equipment is preparing financial statements for the year ended 31 December 20X3. The entity continues to sell specified equipment and management judges that it has no practical ability to withdraw from the market before 20X5.

Present obligation to transfer an economic resource as a result of a past event – The three conditions specified in paragraph 14A of IAS 37 are not all met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if it sells specified equipment in 20X5 (paragraph 14B(a)). The responsibility is owed to the country's government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it sells specified equipment in 20X5 (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay a contribution to disposal costs for historical equipment (paragraph 14I).
Past-event condition	✗	The entity's past manufacture and sale of historical equipment has no bearing on the entity's obligation—disposal costs for historical equipment are allocated without reference to the source of the equipment. Only one action (selling specified equipment in 20X5) will require the entity to transfer an economic resource it would not otherwise have had to transfer (paragraph 14N). The entity has not yet taken this action.

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Conclusion – No provision is recognised at 31 December 20X3.

Example 13A—A levy on revenue

Legislation imposes a levy on entities that generate revenue in a specific market. The amount of the levy is a percentage of the revenue an entity generates in the market in the year to 31 December 20X0. However, only entities that are operating in the market on 1 January 20X1 are within the scope of the levy, and the levy is charged in full on that date. An entity receives no economic resources in exchange for paying the levy.

An entity's reporting period ends on 30 June 20X0. The entity has generated revenue in the market throughout the six months to 30 June 20X0. When preparing the entity's financial statements for the year to 30 June 20X0 management:

(a) assesses all the terms of the legislation and concludes that the requirement to pay the levy is a consequence of taking two separate actions—generating revenue in the market in 20X0 and operating in the market on 1 January 20X1. Both actions are required for the levy to be payable.

(b) judges that the entity has no practical ability to avoid paying the levy if it takes the two actions.

(c) judges that the entity has no practical ability to avoid the second action because the economic consequences for the entity of exiting the market before 20X1 would be significantly more adverse than the cost of paying the levy charged on revenue generated in 20X0.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if it takes two separate actions—generating revenue in the market in 20X0 and operating in the market on 1 January 20X1 (paragraph 14B(a)). The entity owes this responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay a levy without receiving an economic resource in exchange (paragraph 14I).

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Past-event condition	✓	The entity is required to pay a levy if it takes two separate actions—generating revenue in the market in 20X0 and operating in the market on 1 January 20X1. At 30 June 20X0 the entity has taken the first action and has no practical ability to avoid taking the second action (paragraph 14Q). The entity generates revenue throughout the 6 months to 30 June 20X0. Consequently, the past-event condition is met, and the resulting present obligation accumulates, over that time (paragraph 14O). At 30 June 20X0 the entity's present obligation is to pay the levy attributable to the revenue it has generated by that date.

A transfer of economic resources in settlement – Probable.

Conclusion – At 30 June 20X0 a provision is recognised for the levy attributable to revenue generated by that date.

Example 13B—A levy on an entity operating as a bank on the last day of its annual reporting period

A government charges a levy on banks. Any entity that is operating as a bank on the last day of its annual reporting period is within the scope of the levy. The amount of the levy is calculated by reference to the amounts in an entity's statement of financial position at the end of that reporting period. If the reporting period is longer or shorter than 12 months, the levy is increased or reduced proportionately—for example, if an entity has a nine-month reporting period, the levy is 9/12ths of the initial amount calculated. An entity receives no economic resources in exchange for paying the levy.

At the start of an entity's current annual reporting period, the entity is operating as a bank. Management:

(a) assesses all the terms of the legislation and concludes that the requirement to pay the levy is a consequence of the entity taking two separate actions—operating in its current annual reporting period and operating as a bank on the last day of that period. Both actions are required for the levy to be payable.

(b) judges that the entity has no practical ability to avoid paying the levy if it takes the two actions.

(c) judges that the entity has no practical ability to avoid the second action because the economic consequences for the entity of ceasing banking activities before the end of the annual reporting period would be significantly more adverse than the cost of paying the levy charged for that period.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

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Obligation condition	✓	The legislation imposes a responsibility on the entity if it takes two separate actions—operating in its current annual reporting period and operating as a bank on the last day of that period (paragraph 14B(a)). The entity owes the responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it takes the two actions (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay a levy without receiving an economic resource in exchange (paragraph 14I).
Past-event condition	✓	The entity is required to pay a levy if it takes two separate actions—operating in its current annual reporting period and operating as a bank on the last day of that period. From the start of the current annual reporting period, the entity starts to take the first action and has no practical ability to avoid the second action (paragraph 14Q). Because the extent of the entity's obligation depends on the length of its annual reporting period, the present obligation accumulates over the annual reporting period (paragraph 14O).

A transfer of economic resources in settlement – Probable.

Conclusion – At the end of the annual reporting period a provision is recognised for the best estimate of the levy that will be charged for the reporting period.

Example 13C—A property tax

Legislation imposes an annual property tax on land and buildings held for business use. The tax is payable by the party that owns the land and buildings on 31 December each year. The tax is calculated after that date and has to be paid by 30 June in the following year. The owner of the land and buildings on 31 December remains liable to pay the full amount of the tax even if it sells the land and buildings, or changes their use, after that date. The owner receives no economic resources in exchange for paying the tax.

Under the legislation, the amount of tax payable is determined by reference to a specific measure of the value of the land and buildings. The measure is the price paid for the land and buildings by the current owner, increased by the change in a specified price index between the purchase date and the date on which the tax is charged.

On 31 December 20X5 an entity owns and holds for business use land and buildings it bought in 20X0.

When preparing the entity's financial statements for the year ended 31 December 20X5 management:

(a) assesses all the terms of the legislation and concludes that the requirement to pay the tax is a consequence of the entity taking only one action—owning and holding land and buildings for business use on 31 December 20X5. Although buying the land and buildings at an earlier date affects the amount of tax payable,

it is not an action required for tax to be payable—the tax is payable regardless of when land and buildings were bought.

(b) judges that the entity has no practical ability to avoid paying the tax on the land and buildings it owns and holds for business use on 31 December 20X5.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if it owns land and buildings on 31 December 20X5 and holds them for business use on that date (paragraph 14B(a)). The entity owes the responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibility if it meets the ownership and use conditions (paragraph 14B(c)).
Transfer condition	✓	The entity's obligation is to pay a tax without receiving an economic resource in exchange (paragraph 14I).
Past-event condition	✓	As a consequence of owning land and buildings on 31 December 20X5 and holding them for business use on that date, the entity will have to pay a tax it would not otherwise have had to pay (paragraph 14N). The past-event condition is met on 31 December 20X5.

A transfer of economic resources in settlement – Probable.

Conclusion – A provision is recognised on 31 December 20X5 for the full amount of the tax expected to be charged on land and buildings owned on that date.

Example 14—Negative low-emission vehicle credits

A government's legislation applies to entities that produce cars for sale in a specific market in the calendar year 20X0. Under the legislation, these entities:

(a) receive positive credits if in that year they have manufactured cars whose average fuel emissions are *lower* than a government target; or

(b) receive negative credits if in that year they have manufactured cars whose average fuel emissions are *higher* than the target.

The legislation requires an entity that receives negative credits for 20X0 to eliminate those negative credits by obtaining and surrendering positive credits. An entity can obtain positive credits either by buying them from another entity or by generating them itself in 20X1 (by manufacturing in 20X1 cars with average fuel emissions lower than the government target).

Under the legislation, the government cannot force an entity to eliminate its negative credits, but can impose sanctions on an entity that fails to do so. These sanctions would not require payment of fines, or any other transfer of economic resources, but would restrict the entity's access to the market in 20X2 and later years.

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An entity is preparing its financial statements for the year ended 31 December 20X0. In that year, it has produced vehicles with average fuel emissions higher than the government target, so it will receive negative credits. Management expects that the economic consequences for the entity of restricted market access would be significantly more adverse than the costs of obtaining and surrendering enough positive credits to eliminate the negative credits due for 20X0. Management expects the entity to generate the positive credits itself (thus avoiding the need to buy them) by manufacturing in 20X1 cars with average fuel emissions lower than the government target.

Present obligation to transfer an economic resource as a result of a past event – All three conditions specified in paragraph 14A of IAS 37 are met:

Obligation condition	✓	The legislation imposes a responsibility on the entity if in 20X0 it manufactures cars whose average fuel emissions are higher than the government target (paragraph 14B(a)). The entity owes this responsibility to the government, which acts on behalf of society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging this responsibility because the economic consequences for the entity of restricted market access are expected to be significantly more adverse than the costs of obtaining and surrendering enough positive credits to eliminate the negative credits due for 20X0 (paragraphs 14B(c) and 14F(a)).
Transfer condition	✓	The entity's obligation is to surrender positive credits. An entity that surrenders positive credits to eliminate negative credits is transferring an economic resource, even if the entity has generated the positive credits as part of its manufacturing activities (paragraph 14I). Positive credits are an economic resource however obtained—they enable an entity to settle an obligation to eliminate negative credits, and if the entity were not required to use the positive credits in this way, it could have sold them to other entities.
Past-event condition	✓	The entity has taken the action as a consequence of which it will have to surrender positive credits it would not otherwise have had to surrender (paragraph 14N). That action is manufacturing in 20X0 cars whose average fuel emissions are higher than the government target.

A transfer of economic resources in settlement – Probable.

Conclusion – At 31 December 20X0 a provision is recognised for the best estimate of the expenditure required to obtain and surrender enough positive credits to eliminate the negative credits due for 20X0.

Example 15—Climate-related commitments

In 20X0 an entity that manufactures household products publicly states its commitments:

(a) to gradually reduce its annual greenhouse gas emissions, reducing them by at least 60% of their current level by 20X9; and

(b) to offset its remaining annual emissions in 20X9 and in later years by buying carbon credits and retiring them from the carbon market.

To support its statement, the entity publishes a transition plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in its annual emissions by 20X9. The modifications will involve investing in more energy-efficient processes, buying energy from renewable sources and replacing petroleum-based product ingredients and packaging materials with lower-carbon alternatives. Management is confident that the entity can make all these modifications and continue to sell its products at a profit.

In addition to publishing the transition plan, the entity takes several other actions that publicly affirm its commitments.

Having considered all the facts and circumstances of the entity's commitments—including the actions it has taken to affirm them—management judges that the entity's statement has created a valid expectation in society at large that the entity will fulfil the commitments, and hence that it has no practical ability to avoid doing so (paragraph 14F(b)).

The entity is preparing financial statements for the year ended 31 December 20X0.

Present obligation to transfer an economic resource as a result of a past event – The three conditions specified in paragraph 14A of IAS 37 are not all met:

Obligation condition	✓	The entity's public statement of its commitments imposes on the entity responsibilities: (a) to operate in the future in a way that reduces its annual greenhouse gas emissions; and (b) to offset its remaining emissions if it emits greenhouse gases in 20X9 and later years (paragraph 14B(a)). The entity owes those responsibilities to society at large (paragraph 14B(b)). The entity has no practical ability to avoid discharging its responsibilities (paragraph 14B(c)). The obligations meet the definition of a constructive obligation (paragraph 10).

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Transfer condition	✗	**Obligation to reduce emissions** The entity's obligation to operate in the future in a way that reduces its greenhouse gas emissions is not an obligation to transfer an economic resource. Although the entity will incur expenditure in changing the way it operates, it will receive other economic resources—for example, property, plant and equipment, energy, product ingredients or packaging materials—in exchange, and will be able to use these resources to manufacture products it can sell at a profit (paragraph 14L).
	✓	**Obligation to offset remaining emissions** The entity's obligation to offset its remaining annual greenhouse gas emissions in 20X9 and later years is an obligation to transfer an economic resource. The entity will be required to buy and retire carbon credits without receiving any economic resources in exchange (paragraph 14I).
Past-event condition	✗	**Obligation to offset remaining emissions** The entity has not yet taken the action (emitting gases in 20X9 or in a later year) as a consequence of which it will have to buy and retire carbon credits it would not otherwise have had to buy or retire (paragraph 14N).

Conclusion – No provision is recognised at 31 December 20X0.

If the entity emits greenhouse gases in 20X9 and in later years, it will incur a present obligation to offset these past emissions when it emits the gases. If, at that time, the entity has not settled the present obligation and it is probable that it will have to transfer an economic resource to do so, the entity will recognise a provision for the best estimate of the expenditure required.

Although the entity does not recognise a provision for its constructive obligations at 31 December 20X0, the actions it plans to take to fulfil the obligations could affect the amounts at which it measures its other assets and liabilities (for example, its property, plant and equipment), and the information it discloses about them, as required by various IFRS Accounting Standards.

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IFRS® Accounting Standard

Basis for Conclusions on Provisions—Targeted Improvements

Proposed amendments to IAS 37

Comments to be received by 12 March 2025

International Accounting Standards Board

IASB/ED/2024/8

Basis for Conclusions on Exposure Draft *Provisions—Targeted Improvements*

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Basis for Conclusions on Exposure Draft *Provisions—Targeted Improvements*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Provisions—Targeted Improvements. *It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.*

Background

BC1 In 2020 the IASB added a standard-setting project to its work plan, with the objective of making three targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*:

(a) aligning the definition of a liability and the recognition criterion that applies that definition with the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) issued in 2018; and

(b) specifying two aspects of the requirements for measuring a provision:

(i) the costs an entity includes in its estimate of the future expenditure required to settle the present obligation; and

(ii) the rate an entity uses to discount that future expenditure to its present value.

BC2 For each topic, the IASB developed options for possible amendments and consulted stakeholders before making tentative decisions on the proposals included in the Exposure Draft. These stakeholders included:

(a) users of financial statements (investors), including the IASB's Capital Markets Advisory Committee and other groups of equity and debt analysts;

(b) preparers of financial statements, including the IASB's Global Preparers Forum and preparers of the financial statements of entities that could be most affected by the proposed amendments—entities operating in sectors that are subject to levies and entities reporting large long-term asset decommissioning or environmental rehabilitation obligations;

(c) national and regional standard-setting bodies, including the IASB's Accounting Standards Advisory Forum and Emerging Economies Group; and

(d) members of the IFRS Interpretations Committee.

Definitions and present obligation recognition criterion

BC3 The IASB proposes to amend:

(a) the definition of a liability in IAS 37;

(b) the recognition criterion in IAS 37 that uses that definition; and

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(c) the supporting guidance in the *Guidance on implementing IAS 37* Provisions, Contingent Liabilities and Contingent Assets (*Guidance on implementing IAS 37*).

Reasons for proposing amendments

BC4 One of the criteria in IAS 37 for recognising a provision is that the entity has an obligation that meets the definition of a liability. Paragraph 14(a) of IAS 37 requires that the entity has a present obligation (legal or constructive) as a result of a past event (present obligation recognition criterion).

BC5 Paragraphs 17–22 of IAS 37 set out requirements for identifying when an entity has such an obligation, and examples in the *Guidance on implementing IAS 37* illustrate the application of those requirements.

BC6 The IASB is proposing to amend the requirements and examples supporting the present obligation recognition criterion because of:

(a) difficulties faced by preparers of financial statements in disentangling two distinct conditions within the criterion (paragraphs BC8–BC12);

(b) stakeholder dissatisfaction with IFRIC 21 *Levies*, which interprets the present obligation recognition criterion (paragraphs BC13–BC14); and

(c) difficulties in applying the requirements to laws and regulations with novel enforcement mechanisms or settlement options (paragraphs BC15–BC16).

BC7 The proposed amendments would affect only the present obligation recognition criterion. They would not affect the other two recognition criteria in IAS 37, which would continue to require an entity to recognise a provision only if:

(a) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation (paragraph 14(b) of IAS 37); and

(b) a reliable estimate can be made of the amount of the obligation (paragraph 14(c) of IAS 37).

Difficulties in disentangling two distinct conditions within the present obligation recognition criterion

BC8 Paragraphs 17–22 of IAS 37 identify two conditions within the present obligation recognition criterion:

(a) an obligation condition—there exists a mechanism, for example, a law or a policy the entity has published, that imposes responsibilities on the entity and leaves the entity with no realistic alternative to discharging those responsibilities if a specific event occurs; and

(b) a past-event condition—the specific event has occurred and consequently the obligation is a present obligation.

BC9 The obligation and past-event conditions are distinct—the obligation condition relates to the strength of the mechanism that requires the entity to settle a present obligation once it has arisen, whereas the past-event condition relates to the timing of the event that gives rise to the present obligation. However, although the obligation and past-event conditions are distinct, IAS 37 does not identify them separately. Instead, it combines them into a single requirement for an 'obligating event', which paragraph 10 in IAS 37 defines as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation'. The supporting explanations in paragraphs 17–22 of IAS 37 also combine explanations of the obligation and past-event conditions.

BC10 Application problems arise because it can be unclear which condition an explanation refers to, so an explanation of one condition can appear to apply to the other condition. For example, paragraph 19 of IAS 37 refers to an entity having no present obligation if it can avoid future expenditure through its future actions. It is unclear whether this reference applies to actions the entity could take to avoid creating a present obligation (the past-event condition) or to actions it could take to avoid settling the obligation (the obligation condition).

BC11 In response to requests for more guidance for specific fact patterns, the IFRS Interpretations Committee has issued:

(a) two IFRIC® Interpretations: IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21; and

(b) Agenda Decision *Climate-related Commitments* (IAS 37).

BC12 In each case, the IFRS Interpretations Committee applied paragraph 19 of IAS 37 and concluded that an entity does not have a present obligation until it takes the action that triggers a requirement to discharge a responsibility (for example, to pay a levy or to offset greenhouse gas emissions), even if before then the entity would have had no realistic alternative other than to take that action. However, in each case, the conclusions and their rationale would have been easier to explain if IAS 37 more clearly distinguished the obligation condition from the past-event condition.

Stakeholder dissatisfaction with IFRIC 21

BC13 IFRIC 21 includes requirements for circumstances in which a levy is charged only if an entity takes two or more specific actions—for example, if an entity generates revenue in a market in one year and is still operating in that market on a specific date in the next year. IFRIC 21 concludes that a liability to pay the levy arises, and hence a provision is recognised, only when the entity takes the last of those actions, triggering the charge.

BC14 However, IFRIC 21 has been widely criticised by investors, preparers and auditors of financial statements, and national standard-setters. It results in entities recognising some recurring periodic levies as expenses at a single point in time late in the period for which they are charged, or even after the end of that period. Stakeholders have expressed concern about this outcome

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because, in their view, the substance of a recurring levy is that the entity is paying to operate over a period, and this substance would be more faithfully represented if entities recognised the expense systematically over that period. Stakeholders have also noted that the requirements in IFRIC 21 are inconsistent with requirements in IFRS Accounting Standards for other types of costs that are triggered only when an entity takes the last of two or more specific actions—for example, requirements in IFRS 2 *Share-based Payment* and IAS 19 *Employee Benefits.*

Difficulties in applying the requirements to laws and regulations with novel enforcement mechanisms or settlement options

BC15 Further questions have arisen recently because some new laws and regulations have features that differ from those of conventional laws. For example:

(a) the obligations arising under some climate-related regulations are not conventionally enforceable. An entity might not be required to comply with the regulations but might have a strong economic incentive to do so.

(b) an entity might be able to settle its obligations in a novel way—for example, by changing its future operations instead of by paying penalties.

BC16 The IFRS Interpretations Committee considered the implications of such features when asked to analyse government measures to encourage vehicle producers to produce low-emission vehicles. Although the Committee concluded in Agenda Decision *Negative Low Emission Vehicle Credits* (IAS 37) that IAS 37 provides an adequate basis to determine the required accounting, the conclusions and their rationale would have been easier to explain if IAS 37:

(a) more clearly distinguished and explained the obligation and past-event conditions within the present obligation recognition criterion.

(b) provided clearer application guidance on the factors to consider in assessing whether an entity has a realistic alternative to settling an obligation. Currently, paragraph 17 of IAS 37 states that it is necessary that a legal obligation 'can be enforced by law'. However, IAS 37 does not clarify how to interpret this statement if a counterparty cannot use the courts to enforce compliance but has a legal right to impose economic sanctions that might leave an entity with no realistic alternative other than to comply.

Revisions to the *Conceptual Framework*

BC17 The criticisms of IFRIC 21 described in paragraph BC14 highlight a question the IASB has considered in developing various IFRS Accounting Standards—whether and, if so, when a liability arises for an obligation that depends on an entity taking two or more separate actions. The IASB decided to answer this question as part of its project to revise the *Conceptual Framework* because the same question arises for various types of transactions—for example, share-based payments, variable lease payments and purchases subject to variable or

contingent consideration. The IASB added concepts to address this question to the *Conceptual Framework* in 2018.

BC18 Although the IASB designed these concepts to have general applicability, it developed them with IAS 37 in mind. The IASB included concepts in the *Conceptual Framework* that it could apply in developing requirements for IAS 37 that would be clearer and result in more useful information for investors.

BC19 The *Conceptual Framework*:

(a) has an updated definition of a liability;

(b) distinguishes three conditions within the definition of a liability—obligation, transfer and past-event conditions—and explains each of these three conditions separately without referring to obligating events;

(c) identifies various circumstances in which an entity might have no realistic alternative to settling an obligation, considering the role of economic incentives; and

(d) provides new concepts for identifying the past event that gives rise to a present obligation.

BC20 The *Conceptual Framework* uses different terminology from that in IAS 37, referring to an entity's 'practical ability to avoid' an obligation rather than its 'realistic alternative to settling' the obligation. However, the Basis for Conclusions on the *Conceptual Framework* clarifies that the IASB viewed these two terms as having a similar meaning.[1]

Proposed amendments to IAS 37

BC21 The amendments proposed in the Exposure Draft use the concepts added to the *Conceptual Framework* to address the problems described in paragraphs BC8–BC16. The proposed amendments consist of:

(a) updating the definition of a liability to align it with the definition in the *Conceptual Framework* (paragraphs BC22–BC24);

(b) aligning the wording of the present obligation recognition criterion with the updated definition of a liability (paragraph BC25);

(c) removing the term 'obligating event' and instead identifying and explaining three conditions (obligation, transfer and past-event conditions) within the present obligation recognition criterion (paragraphs BC26–BC33);

(d) redefining a past event (paragraphs BC34–BC36);

(e) adding requirements for threshold-triggered costs (paragraphs BC37–BC47); and

1 See paragraph BC4.57 of the Basis for Conclusions on the *Conceptual Framework for Financial Reporting*.

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(f) improving the wording of the requirements for restructuring costs without changing the substance of those requirements (paragraphs BC48–BC52).

Updating the definition of a liability

BC22 The IASB proposes to update the definition of a liability in paragraph 10 of IAS 37 to align it with the definition in paragraph 4.2 of the *Conceptual Framework*.

BC23 IAS 37 is the only IFRS Accounting Standard that uses a definition of a liability that predates the *Conceptual Framework* definition. Updating the definition in IAS 37 would result in IFRS Accounting Standards using a single definition of a liability, which could reduce complexity for preparers of financial statements. For example, in developing an accounting policy for a transaction not specifically addressed by any IFRS Accounting Standard, preparers would no longer be required to decide whether to apply the IAS 37 definition or the *Conceptual Framework* definition.

BC24 Updating the definition of a liability in paragraph 10 of IAS 37 would require minor consequential amendments to various other paragraphs in IAS 37 that include words or phrases from the definition. These consequential amendments are set out in Appendix A to the Exposure Draft.

Aligning the wording of the present obligation recognition criterion with the updated definition of a liability

BC25 The present obligation recognition criterion in paragraph 14(a) of IAS 37 is a requirement for an entity to have an obligation that meets the definition of a liability. The IASB proposes to align the wording of this criterion with the updated definition of a liability to make that relationship clearer.

Identifying three conditions within the present obligation recognition criterion

BC26 To clarify the present obligation recognition criterion, the IASB proposes to remove the requirement for an obligating event (paragraph 17 of IAS 37) and replace it with a requirement to meet the three distinct conditions—obligation, transfer and past-event conditions—identified in paragraph 4.27 of the *Conceptual Framework* (paragraph 14A of the Exposure Draft).

BC27 The IASB proposes separate sections of requirements to support each of the conditions. In developing these requirements, the IASB has applied concepts set out in the corresponding sections of the *Conceptual Framework*.

Clarifying the requirements supporting the obligation condition

BC28 Paragraph 4.29 of the *Conceptual Framework* defines an obligation as 'a responsibility that an entity has no practical ability to avoid'. In paragraph 14B of the Exposure Draft, the IASB proposes to use that definition as the basis for the definition in IAS 37. The IASB has previously concluded that the meaning of 'no practical ability to avoid' is similar to that of 'no realistic alternative to settling' (see paragraph BC20). Therefore, it does not expect the change in terminology to change the outcomes of applying IAS 37.

BC29 The paragraphs explaining the obligation condition (paragraphs 14B–14H of the Exposure Draft) have two main aims. The first aim is to clarify that the 'no practical ability to avoid' requirement in the obligation condition refers to an entity's ability to avoid discharging a responsibility *if* it obtains specific benefits or takes a specific action, not its ability to avoid obtaining those benefits or taking that action. In other words, the obligation condition requires an assessment of the entity's practical ability to avoid settling an obligation once that obligation has been created, not the entity's practical ability to avoid obtaining the benefits or taking the action that creates the obligation. The entity's ability to avoid obtaining the benefits or taking the action is considered separately, in applying the past-event condition.

BC30 A second aim of the paragraphs supporting the obligation condition is to clarify the circumstances in which an entity has no practical ability to avoid discharging a legal responsibility. The IASB proposes to remove the statement specifying that it is necessary that settlement of a legal obligation 'can be enforced by law' (paragraph 17 of IAS 37) because the phrase 'enforced by law' has proved difficult to apply to some types of obligations within the scope of IAS 37. The phrase can be interpreted narrowly, to mean that the counterparty can use the courts to enforce compliance (see paragraph BC16(b)). For some types of obligations within the scope of IAS 37, this narrow interpretation might be inconsistent with the broader notion of 'no practical ability to avoid'—an entity might have no practical ability to avoid discharging a legal obligation for reasons other than the counterparty's ability to use the courts to enforce compliance.

BC31 In paragraph 14F(a) of the Exposure Draft, the IASB proposes to replace the requirement that a legal obligation can be 'enforced by law' with a more detailed description of circumstances in which an entity would have no practical ability to avoid discharging a legal obligation. The proposed description is based on concepts in paragraph 4.34 of the *Conceptual Framework*. These concepts focus on the effects of the counterparty's rights on the entity's ability to avoid discharging a legal responsibility, not on the form of the rights.

Adding requirements to support the transfer condition

BC32 The proposed new explanation of the transfer condition (paragraphs 14I–14L of the Exposure Draft) reflects concepts from the *Conceptual Framework*. The IASB proposes to add these concepts to explain:

(a) the need for the obligation to have only the potential to require a transfer of an economic resource—a transfer need not be certain or even likely;

(b) the consequences of uncertainty about whether the obligation will require a transfer of an economic resource; and

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(c) the reason that a provision is recognised for an obligation to exchange resources only if the exchange is unfavourable to the entity—for example, if an executory contract is onerous. No provision is recognised in other circumstances because the obligation does not meet the transfer condition.

BC33 In paragraph 3 of the Exposure Draft, the IASB proposes to amend the description of an executory contract to align it with the definition in paragraph 4.56 of the *Conceptual Framework*. This amendment is intended only to eliminate an unnecessary wording difference within IFRS Accounting Standards. It is not intended to change the meaning of the term executory contract as it is applied in IAS 37.

Redefining a past event

BC34 In paragraphs 14M–14R of the Exposure Draft, the IASB proposes new requirements for identifying the past event that gives rise to a present obligation. The IASB developed those requirements by applying concepts in paragraphs 4.43–4.44 and 4.32–4.33 of the *Conceptual Framework*. The proposed requirements aim to address the criticisms of IFRIC 21 discussed in paragraphs BC13–BC14—in particular, the criticisms relating to the outcomes of applying IFRIC 21 to levies charged only if an entity takes two or more specific actions. The proposed requirements would replace the current requirements in paragraph 19 of IAS 37, and IFRIC 21 would be withdrawn.

BC35 The proposed requirements would change the timing of recognition of some provisions. The timing would change for a transfer of economic resources that is required only if an entity takes two or more separate actions. Currently, an entity applying paragraph 19 of IAS 37, as interpreted by IFRIC 21, is regarded as having met the past-event condition only when it has taken the *last* of the required actions, thus triggering the transfer. In contrast, an entity applying the proposed requirements would be regarded as having met the past-event condition as soon as it had taken *any* of the actions and if it had no practical ability to avoid the remaining actions. Assuming the other recognition criteria are met, the latter entity might recognise a provision earlier and might accrue that provision progressively instead of recognising it at a point in time. The aim of the proposed requirements is to provide more useful information to investors, as explained in paragraphs BC4.51–BC4.52 of the Basis for Conclusions on the *Conceptual Framework*.

BC36 The IASB noted that whether an entity's obligation to transfer an economic resource requires only one action of the entity (perhaps taken over time), or a combination of two or more separate actions, will depend on the precise facts of the mechanism that has created the obligation—for example, the precise terms of a contract or requirements of legislation. Management would reach a conclusion by assessing all the relevant facts of the mechanism, including, for example, facts about the effects on the obligation of variations in an entity's circumstances.

Adding requirements for threshold-triggered costs

BC37 In paragraph 14P of the Exposure Draft, the IASB proposes to add to IAS 37 requirements for costs payable if a measure of an entity's activity in a specific period exceeds a specific threshold (threshold-triggered costs). The proposed requirements aim to clarify when the past-event condition is met for such costs.

BC38 Examples of such costs are:

(a) levies payable by larger entities operating within a market—for example, levies payable by entities whose annual revenue exceeds a specific amount; and

(b) some costs imposed by pollutant pricing mechanisms and other climate-related regulations—for example, penalties imposed on an entity whose greenhouse gas emissions in a specific assessment period exceed a quota allocated to that entity.

BC39 Stakeholders have told the IASB that specific requirements are necessary for threshold-triggered costs because:

(a) such costs are common in some sectors—for example, pharmaceutical or oil and gas—and are becoming more common because they are a feature of some climate-related regulations;

(b) questions arise in practice about whether the past-event condition for a threshold-triggered cost is met:

(i) when an entity starts to carry out the activity that contributes to the total activity on which the cost is assessed (if the entity expects that activity to exceed the threshold in the assessment period); or

(ii) only when the entity's activity exceeds the threshold;

(c) without specific requirements, there is a risk of inconsistent application of the more general requirements in IAS 37; and

(d) specific requirements would be especially useful for interim financial statements.

BC40 The requirements proposed in paragraph 14P of the Exposure Draft are an interpretation of the more general requirements proposed in paragraph 14N, which state that an entity has a present obligation as a result of a past event when it:

(a) has obtained specific economic benefits or taken a specific action; and

(b) as a consequence, will or may have to transfer an economic resource it would not otherwise have had to transfer.

BC41 The requirements proposed in paragraph 14P of the Exposure Draft are based on the IASB's conclusion that the action that satisfies the past-event condition is all activity that contributes to the total activity on which the cost is assessed, both activity below the threshold and activity above the threshold.

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The consequence of this conclusion is that the past-event condition starts to be met as soon as an entity starts carrying out the activity that contributes to the total being assessed. The present obligation accumulates as that activity progresses.

BC42 The IASB is proposing these requirements having concluded that, regardless of whether an entity's activity at a date within the assessment period is below or above the threshold, the fact that the entity has carried out activity that takes it towards or further above the threshold affects the costs it might incur. An entity whose activity is closer to the threshold might incur a cost that it would not have incurred without that activity.

BC43 Some stakeholders the IASB consulted expressed a view that an entity should recognise a provision for a threshold-triggered cost only when the entity's activity exceeds the threshold. These stakeholders said that:

(a) estimating the amount of the obligation before the activity exceeds the threshold could be difficult and costly for preparers of financial statements, especially in borderline cases—for example, if the threshold is unlikely to be exceeded until near the end of the assessment period.

(b) the resulting estimates could be highly subjective, especially if there is a lack of historical information on which to base estimates or a history of poor judgement by management. In some cases, an entity might recognise a provision in one period and reverse it in a later period if expectations change.

(c) a requirement to recognise a provision only after an entity's activity exceeds the threshold would be clearer and easier to apply.

BC44 However, the IASB concluded that:

(a) a present obligation for a threshold-triggered cost starts to arise when an entity starts to carry out the activity on which the cost is assessed.

(b) accruing a provision based on the expected cost attributable to each unit of activity would provide useful information to investors. In contrast, recognising a provision only after the threshold has been met could provide misleading information to investors. Recognition at this stage might not faithfully represent the entity's financial performance and financial position in its (interim) financial statements for periods before and after the threshold is met.

BC45 The IASB further noted that an entity applying the proposed amendments would not necessarily recognise a provision before its activity exceeded the threshold. The entity would recognise a provision only if the other recognition criteria in IAS 37 were also met, that is, if:

(a) it were probable that a transfer of economic resources would be required to settle the obligation (paragraph 14(b) of IAS 37); and

(b) a reliable estimate could be made of the amount of the obligation (paragraph 14(c) of IAS 37).

BC46 The IASB concluded that, as a consequence, an entity would recognise a provision for a threshold-triggered cost only if:

(a) the entity's activity for the assessment period were expected to exceed the threshold; and

(b) the entity could make a forecast of the total activity for the assessment period that was sufficiently reliable to use in recognising the provision (as required by paragraph 25 of IAS 37).

BC47 The requirements proposed in paragraph 14P of the Exposure Draft are consistent with:

(a) requirements in IAS 12 *Income Taxes* for measuring tax liabilities when different tax rates apply to different levels of taxable income; and

(b) requirements in IAS 19 for employee profit-sharing and bonus payments payable only if specific conditions are met.

IAS 12 and IAS 19 treat the liability as arising in the period in which the entity generates taxable income or receives employee services, and they require liabilities to be recognised by estimating and apportioning the total amounts expected to be payable for that period.

Improving the wording of the requirements for restructuring costs

BC48 Paragraphs 70–83 of IAS 37 set out recognition requirements for restructuring provisions. They:

(a) require an entity to recognise a restructuring provision when it has a 'constructive obligation to restructure'; and

(b) state that a constructive obligation to restructure arises when an entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

BC49 The IASB has become aware that inappropriate analogies are being drawn from these requirements because the wording implies that the public announcement of a restructuring plan is enough to meet the past-event condition and thus create a present obligation for restructuring costs. By analogising to the requirements for restructuring provisions, stakeholders have sometimes concluded that an entity that has publicly announced a plan to change its operations in the future—for example, to reduce its annual greenhouse gas emissions in future years—has a present obligation for the future costs of changing its operations.

BC50 The IASB has concluded that some of the wording of the requirements in IAS 37 for restructuring provisions contributes to the misunderstanding. IAS 37 should not refer to a 'constructive obligation to restructure' because:

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(a) restructuring is an activity implemented for the benefit of the entity, not an obligation owed to another party. An entity does not have an obligation to restructure but rather might have obligations to discharge specific responsibilities *if* it restructures—for example, to pay redundancy costs to employees whose employment is terminated as part of the restructuring.

(b) the obligations arising from a restructuring are not necessarily constructive. They are created by mechanisms other than the implementation or announcement of a restructuring plan. The mechanism creating an obligation could be:

  (i) legal—for example, a statutory or contractual requirement to pay termination benefits to employees; or

  (ii) constructive—for example, an entity's statement that it will provide employees with termination benefits beyond those to which the employees are legally entitled.

(c) the obligations are present obligations (meaning the past-event condition is met) only if the requirement to pay the restructuring costs is a consequence of the entity:

  (i) having obtained specific economic benefits or taken a specific action in the past—for example, having employed and obtained services from employees in the past; and

  (ii) having no practical ability to avoid a second specific action required to trigger the payments—for example, making these employees redundant—because it has no practical ability to avoid the restructuring.

BC51 The IASB has concluded that although some of the wording of the restructuring requirements in IAS 37 appears inconsistent with the analysis in paragraph BC50, the requirements themselves are consistent with that analysis. The requirements in IAS 37 are such that for a provision to be recognised, it is necessary that the entity has announced or started to implement a restructuring plan, and thus has no practical ability to avoid the restructuring. It is also necessary that the costs included in the provision arise from the entity having taken a specific action or obtained specific benefits in the past—for example, having employed and obtained services from employees in the past. This requirement is reflected in paragraph 80 of IAS 37, which requires entities to exclude from a restructuring provision costs associated with the ongoing activities of the entity.

BC52 The proposed amendments to paragraphs 72–83 of IAS 37 aim to eliminate potentially misleading terminology and explain the requirements for restructuring provisions more clearly, to reduce the risk of inappropriate analogies being drawn from the requirements. The amendments are not intended to change the outcomes of applying the requirements for restructuring provisions.

Paragraph-by-paragraph explanation of proposed amendments

BC53 The amendments necessary to achieve the aims described in paragraphs BC26–BC47 are interrelated. The IASB proposes to achieve these aims by replacing paragraphs 17–22 of IAS 37 with new paragraphs numbered 14A–14U and by amending paragraphs 15–16 of IAS 37.

BC54 Appendix A to this basis for conclusions provides a paragraph-by-paragraph explanation of these proposed amendments. For each new or amended paragraph, it:

(a) identifies the function of the proposed requirement and its source—typically an existing paragraph in IAS 37 or a paragraph in the *Conceptual Framework*; and

(b) explains the contribution the paragraph makes to achieving the overall aims of the amendments.

Proposed amendments to the *Guidance on implementing IAS 37*

BC55 The *Guidance on implementing IAS 37* published with IAS 37 includes:

(a) a decision tree illustrating the process an entity follows in applying the three recognition criteria in paragraph 14 of IAS 37, and the consequences of meeting or failing to meet each criterion; and

(b) examples showing how to apply the present obligation recognition criterion to various fact patterns.

Expanding the decision tree

BC56 The proposed amendments to the present obligation recognition criterion would split the criterion into three separate conditions: obligation, transfer and past-event conditions. The IASB proposes to expand the decision tree in the *Guidance on implementing IAS 37* to show how a step-by-step assessment of these three conditions would fit into the wider process followed by an entity in applying the recognition criteria.

BC57 The proposed new decision tree also shows more prominently the consequence of an obligation failing to meet the present obligation recognition criterion; namely that the entity has neither a provision nor a contingent liability. Giving more prominence to this consequence could help overcome a common misunderstanding, which is that an obligation that fails any of the criteria for recognising a provision is a contingent liability.

Adding illustrative examples

BC58 The IASB proposes to add further examples to the *Guidance on implementing IAS 37*. These proposed examples illustrate the application of the recognition criteria to fact patterns similar to those in:

(a) IFRIC 6 (proposed Example 12);

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(b) Illustrative Examples accompanying IFRIC 21 (proposed Example 13A and Example 13B);

(c) Agenda Decision *Negative Low Emission Vehicle Credits* discussed in paragraph BC16 (proposed Example 14); and

(d) Agenda Decision *Climate-related Commitments* discussed in paragraph BC11 (proposed Example 15).

BC59 Adding these examples to the *Guidance on implementing IAS 37* would allow the IASB to withdraw the interpretations and agenda decisions without losing an analysis of the fact patterns they discuss. Moving that analysis to the *Guidance on implementing IAS 37* would also help consolidate the guidance in one place, making it more accessible. Including examples illustrating the application of the proposed new requirements to levies with fact patterns like those accompanying IFRIC 21 would help illustrate how the outcomes of applying the proposed requirements differ from the outcomes of applying IFRIC 21.

Amending existing examples

BC60 The IASB proposes to amend the analysis in the existing examples in the *Guidance on implementing IAS 37* to reflect the proposed new requirements supporting the present obligation recognition criterion. In the IASB's view, none of the conclusions on whether a provision is recognised would change, but some would be explained in another way.

BC61 The IASB proposes to expand the analysis of each example to include a conclusion on whether each of the three conditions within the present obligation recognition criterion is met. The aim of expanding the analysis in this way is to further clarify the three conditions to help preparers of financial statements apply them to other fact patterns, including new fact patterns that might emerge in the future. In practice, it might be unnecessary to assess all three conditions, because failing to meet any one condition is sufficient to conclude that the present obligation recognition criterion is not met.

BC62 The IASB proposes to delete Example 4 (Refunds policy) because, following the issue of IFRS 15 *Revenue from Contracts with Customers*, this example is no longer applicable.

Measurement—Expenditure required to settle an obligation

BC63 In May 2020 the IASB issued a narrow-scope amendment to IAS 37, adding paragraph 68A. Paragraph 68A specifies the costs an entity includes in assessing whether a contract is onerous, and hence in determining whether the entity recognises an onerous contract provision. It requires an entity to include the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling contracts—for example, an allocation of the depreciation charge for an item of plant or equipment.

BC64 While the IASB was developing that narrow-scope amendment, some stakeholders asked it to clarify:

(a) whether an entity that has used the costs set out in paragraph 68A of IAS 37 to determine whether a contract is onerous is required to include the same costs in measuring the resulting onerous contract provision; and

(b) whether an entity is also required to include the same types of costs in measuring other types of provisions within the scope of IAS 37.

BC65 The IASB decided not to respond to these questions at the time because doing so would have delayed an urgent amendment. Paragraph BC19 of the Basis for Conclusions on IAS 37 includes a statement that adding paragraph 68A to IAS 37 does not change the requirements in the Standard beyond clarifying the costs an entity is required to consider in determining whether a contract is onerous.

BC66 This statement leaves open the question of which costs an entity includes in measuring an onerous contract provision and, more broadly, in measuring any type of provision within the scope of IAS 37. To answer this question, the IASB proposes to specify that, in measuring a provision, an entity includes the types of costs it would include in assessing whether a contract is onerous. This proposal reflects the IASB's view that:

(a) the basis for measuring an onerous contract provision should be consistent with the basis on which the contract has been assessed to be onerous; and

(b) the arguments on which the IASB based its conclusions about the costs of fulfilling an onerous contract obligation (see paragraphs BC4–BC13 of the Basis for Conclusions on IAS 37) apply equally to the expenditure required to settle other types of provisions within the scope of IAS 37.

Measurement—Discount rates

Determining the discount rate

Current requirements

BC67 Paragraph 36 of IAS 37 requires an entity to measure a provision by estimating the expenditure required to settle the present obligation. Paragraph 45 of IAS 37 requires the entity to discount this expenditure to its present value if the effect of the time value of money is material. Paragraph 47 of IAS 37 requires an entity to discount the expenditure at a rate that reflects:

(a) current market assessments of the time value of money; and

(b) the risks specific to the liability, to the extent that these risks are not reflected in the cash flows.

BC68 The risks specific to the liability include the uncertainty in the amount or timing of the expenditure required to settle the liability. This type of risk typically increases the measure of the liability, and it can be reflected by:

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(a) increasing the estimate of the expenditure required to settle the liability (increasing the estimated expenditure to its certainty equivalent amount[2]); or

(b) decreasing the rate used to discount the estimated expenditure to its present value.

BC69 IAS 37 does not specify whether the risks specific to the liability also include non-performance risk—the risk that the entity will not settle the liability. If non-performance risk is reflected, the amount at which a liability is measured decreases. Non-performance risk is reflected by increasing the discount rate.

BC70 The non-performance risk associated with a provision might differ from the non-performance risk associated with an entity's other liabilities. For example, regulations governing asset decommissioning and environmental rehabilitation obligations sometimes reduce the non-performance risk associated with these obligations by requiring entities to fund the obligations, or by ranking the obligations higher than other liabilities in a liquidation.

Reasons for specifying whether to include or exclude non-performance risk

BC71 In the absence of specific requirements in IAS 37 on whether and how to include non-performance risk, practice varies:

(a) some entities exclude non-performance risk. Their accounting policy is to apply a risk-free rate, which they typically determine by reference to an observable market proxy for a risk-free rate—for example, the current yield on a low-risk government bond in a currency consistent with that of the provision.

(b) some entities include an entity-specific measure of non-performance risk. Their accounting policy is to apply a 'credit-adjusted' rate, which they might determine by reference to:

(i) the entity's incremental or average borrowing rate; or

(ii) an observable market proxy for a risk-free rate adjusted for the entity's credit spread.

(c) some entities include a market measure of non-performance risk—the non-performance risk in a particular class (or classes) of investment—for example, AA-rated corporate bonds. Such entities determine the discount rate by reference to the current market yield on that type of investment.

BC72 An entity that includes non-performance risk in the discount rate recognises smaller provisions than an entity that excludes that risk. The differences can be significant for large long-term provisions, such as the asset decommissioning and environmental rehabilitation provisions recognised by entities operating in the power generation, oil and gas, mining, and telecommunications sectors.

2 The maximum amount at which the entity would be willing to exchange its liability for one with certain cash outflows of the same amount.

BC73 If two entities use discount rates calculated on different bases for similar provisions, investors might have difficulty comparing the effect of those provisions on the entities' financial performance and financial position. To make comparisons, investors would need to adjust the amounts one entity reports so they are calculated on the same basis as the amounts the other entity reports. The calculations required are sometimes complex, and not all entities disclose the information necessary to make the appropriate adjustments.

BC74 Almost all stakeholders the IASB consulted said they would be in favour of amendments to IAS 37 to improve comparability. A few of those stakeholders said they thought it might be enough to enhance the disclosure requirements, but most said the IASB should standardise the rates entities use, by specifying in IAS 37 whether and how the rate includes non-performance risk.

Reasons for requiring entities to exclude non-performance risk

BC75 In paragraph 47 of the Exposure Draft, the IASB proposes to specify that an entity discounts a provision at a rate that reflects current market assessments of the time value of money, represented by a risk-free rate, with no adjustment for non-performance risk. An entity could estimate an appropriate rate by reference to an observable market proxy for a risk-free rate.

BC76 In reaching its conclusion that the rate should exclude non-performance risk, the IASB considered the alternative views of some stakeholders. As explained further in Appendix B, these stakeholders argued that a rate that *includes* non-performance risk:

(a) can be justified conceptually and results in information that could be useful to investors; and

(b) can be viewed as consistent with both:

  (i) the measurement objective of IAS 37; and

  (ii) the requirement in paragraph 47 of IAS 37 to reflect risks 'specific to the liability'.

BC77 However, as also explained further in Appendix B, the IASB noted it can be argued that a rate that excludes non-performance risk also fulfils these criteria. One conceptual justification for excluding non-performance risk reflects a difference between provisions within the scope of IAS 37 and liabilities that arise from exchange transactions. Provisions within the scope of IAS 37 (for example, asset decommissioning obligations) typically do not include an obligation for an entity to pay the counterparty compensation for accepting non-performance risk. By discounting a provision (and hence unwinding the discount) at a rate that excludes non-performance risk, an entity faithfully represents the fact that it does not incur an expense for transferring that risk.

BC78 In reaching its conclusion that the rate should exclude non-performance risk, the IASB considered two other factors:

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(a) first, the IASB noted a preference among many stakeholders, including users and preparers of financial statements, for a rate that can be determined objectively by reference to an observable market rate. The non-performance risk associated with a provision is not observable and, as explained in paragraph BC70, can differ from the non-performance risk associated with an entity's other liabilities. Therefore, any estimate of the adjustment required to reflect non-performance risk could be highly subjective. Investors have said this subjectivity would reduce comparability. Preparers of financial statements have said the adjustment could be difficult and costly to estimate and audit.

(b) second, the IASB noted that the outcomes of measuring a provision at an amount that reflects the entity's own credit standing can be counter-intuitive. An entity with a weak credit standing reports a smaller liability than an entity with a stronger credit standing, and an entity with a deteriorating credit standing reports a reduction in its liabilities.

BC79 A few stakeholders said they would favour including non-performance risk in the discount rate because doing so would make the requirements in IAS 37 for asset decommissioning and associated environmental rehabilitation obligations more consistent with those in US generally accepted accounting principles (US GAAP). Under US GAAP, an entity measures these obligations using a credit-adjusted discount rate.[3]

BC80 However, the IASB concluded that a requirement to include non-performance risk in the measure of a provision would only marginally improve consistency between IAS 37 and US GAAP requirements because:

(a) the credit-adjusted rate entities use in applying US GAAP differs from the rate IAS 37 would require if it were to mandate inclusion of non-performance risk. The credit-adjusted rate entities use in applying US GAAP reflects those entities' credit standing at the date of initial recognition, but does not reflect:

(i) changes in their credit standing after initial recognition; or

(ii) the non-performance risk specifically associated with the liability being measured.

(b) there are several other differences between IAS 37 and US GAAP requirements for recognising and measuring asset retirement and associated environmental rehabilitation obligations.

Application guidance

BC81 The IASB proposes to add no application guidance to IAS 37 on how an entity determines an appropriate risk-free discount rate. In reaching this decision, the IASB noted that:

3 US GAAP requirements are set out in FASB ASC Subtopic 410–20 *Asset Retirement and Environmental Obligations*.

(a) practice is already well-established without guidance in IAS 37. Many preparers of financial statements already estimate a risk-free rate for measuring provisions, either to implement a policy of discounting at a risk-free rate or as the starting point for estimating a credit-adjusted rate.

(b) provisions within the scope of IAS 37 vary widely in their terms and the circumstances of their settlement. The IASB cannot develop guidance to cover all possible terms and circumstances and so might be unable to develop any guidance beyond basic principles that are already widely understood.

(c) several other IFRS Accounting Standards require assets or liabilities to be measured by reference to risk-free interest rates. Any guidance added to IAS 37 could have unintended consequences for those other Standards.

BC82 Typically, entities determine an appropriate risk-free rate by reference to an observable market proxy for a risk-free rate, such as the current yield on a low-risk government bond in a currency consistent with that of the provision. In some cases, an entity might adjust that yield—for example, to compensate for differences between the duration and liquidity of the investment and those of the provision. However, the IASB does not expect all entities to make such adjustments.

Disclosure—Discount rates

BC83 In response to requests from investors, the IASB proposes to add to IAS 37 requirements for an entity to disclose for each class of provision:

(a) the discount rate (or rates) used in measuring the provision; and

(b) the approach used to determine that rate (or those rates).

BC84 Investors giving feedback on the discount rate requirements in IAS 37 said comparability is impaired not only by diversity in the rates used, but also by a lack of information about those rates. Investors noted that other IFRS Accounting Standards that require entities to measure an asset or a liability using present value cash flow techniques—for example, IAS 19 and IAS 36 *Impairment of Assets*—also require entities to disclose the discount rates they have used. IAS 37 is, therefore, unusual in not requiring entities to disclose discount rates used.

BC85 The proposal to require an entity to disclose the approach it used to determine its discount rates follows from the proposal not to add application guidance to IAS 37 on how to determine an appropriate risk-free rate. The proposal acknowledges that entities could use various approaches and that information about the approach used would enhance comparability. The proposed requirement is consistent with a requirement in IFRS 17 *Insurance Contracts* to disclose the approach used to determine the discount rates used in measuring insurance contract liabilities.[4]

4 See paragraph 117(c)(iii) of IFRS 17 *Insurance Contracts*.

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Withdrawal of IFRIC 6 and IFRIC 21

BC86 The IASB proposes to withdraw both IFRIC 6 and IFRIC 21 because the proposed requirements supporting the present obligation recognition criterion would supersede the requirements in those Interpretations. As discussed in paragraphs BC58–BC59, the IASB proposes to add to the *Guidance on implementing IAS 37* examples illustrating fact patterns like those described in IFRIC 6 and IFRIC 21, so the analysis in these Interpretations would not be lost.

Transition requirements

Entities applying IFRS Accounting Standards

BC87 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to account for a change in an accounting policy resulting from the initial application of an IFRS Accounting Standard:

(a) in accordance with the transition requirements set out in that Standard if it includes such requirements; or

(b) retrospectively if the Standard has no transition requirements.

BC88 The IASB concluded that the costs of retrospective application of some of the amendments proposed in the Exposure Draft could exceed the benefits. Therefore, it is proposing a general requirement for retrospective application with two simplifying exceptions. These exceptions are explained in paragraphs BC90–BC98.

BC89 Some provisions, for example, provisions for asset decommissioning obligations, are added to the cost of the asset to which they relate. Paragraph 94C of the Exposure Draft clarifies that if an entity adjusts a provision for such an obligation, the entity might also need to adjust the carrying amount of the related asset. The requirement for an entity to recognise the net difference as at the transition date in equity clarifies that the entity does not adjust the carrying amount of goodwill acquired in business combinations occurring before that date (subject to the requirements in paragraph 45 of IFRS 3 *Business Combinations*).

Modified retrospective approach for changes in costs included in the measure of a provision

BC90 The first exception to retrospective application is set out in paragraph 94D of the Exposure Draft. This exception specifies a modified retrospective approach for changes in the costs included in the measure of a provision resulting from the amendment proposed in paragraph 40A of the Exposure Draft.

BC91 The IASB is proposing this modified retrospective approach because:

(a) the IASB required this approach when it amended IAS 37 in 2020 to specify the costs an entity includes in assessing whether a contract is onerous; and

(b) the amendments proposed in paragraph 40A follow from the 2020 amendment described in (a). The arguments made in support of the modified retrospective approach specified in the 2020 amendment (see paragraphs BC20–BC21 of the Basis for Conclusions on IAS 37) also apply to the amendment proposed in paragraph 40A.

Simplified approach for changes in discount rates

BC92 The second exception to retrospective application is set out in paragraph 94E of the Exposure Draft. This exception would permit a simplified retrospective approach for changes in discount rates resulting from the amendments proposed in paragraph 47A of the Exposure Draft. The simplification would apply to changes affecting the measure of a provision for asset decommissioning or restoration costs, if those costs are added to the cost of a related asset—for example, related property, plant and equipment or a related lease right-of-use asset. The proposed exception is similar to the exception set out in paragraph D21 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The reason for proposing the exception is explained in paragraphs BC93–BC98 below.

BC93 In paragraph 47A of the Exposure Draft, the IASB proposes to specify that the rate an entity uses to discount a provision reflects current market assessments of the time value of money, represented by a risk-free rate, without adjustment for non-performance risk.

BC94 An entity that currently discounts an asset decommissioning or restoration provision at a rate that includes non-performance risk would need to change its accounting policy to use a lower rate, with a resulting increase in the measure of the provision.

BC95 The IASB concluded that applying the change in accounting policy retrospectively could be difficult if the corresponding debit is added to the cost of the related asset.

BC96 The difficulty would arise because:

(a) IAS 37 requires an entity to measure a provision using current estimates of the expenditure required to settle the present obligation and a current market assessment of the time value of money. Consequently, the measure of an asset decommissioning or environmental rehabilitation provision can fluctuate between reporting dates due to changes in estimates of the required expenditure or changes in current market interest rates.

(b) IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires the fluctuations described in (a) to be added to, or deducted from, the cost of the related asset. Consequently, the fluctuations are generally recognised in the statement of profit or loss prospectively as the related asset is depreciated over its useful life or becomes impaired. Accordingly, the carrying amount of the asset at the date of transition could depend on when and how estimates of required expenditure and market interest rates fluctuated from the date the decommissioning obligation arose.

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(c) therefore, retrospective application of the change in accounting policy would necessitate an entity constructing a historical record of every adjustment that would have been made to the asset's cost and accumulated depreciation at each reporting date between initial recognition of the provision and the date of transition.

BC97 The IASB previously concluded that constructing such a historical record would be impracticable for first-time adopters of IFRS Accounting Standards.[5] For this reason, IFRS 1 exempts first-time adopters from applying IFRIC 1 for fluctuations in estimates of the cash outflows and market interest rates that occurred before the date of transition to IFRS Accounting Standards. Paragraph D21 of IFRS 1 sets out a simplified retrospective approach for an entity that chooses to use this exemption. Applying that simplified approach, an entity measures the provision at the date of transition in accordance with the requirements in IAS 37 and estimates the amount that would have been included in the cost and accumulated depreciation of the related asset using simplifying assumptions.

BC98 The IASB has concluded that a similar exemption would be justified for an entity that changes its accounting policy as a result of the amendments proposed in the Exposure Draft.

First-time adopters of IFRS Accounting Standards

BC99 IFRS 1 requires first-time adopters of IFRS Accounting Standards to apply the requirements retrospectively, with some exceptions. When the IASB issues a new Standard or makes significant changes to a Standard, it considers whether to remove any of those exceptions and whether to add more.

BC100 The IASB proposes no changes to the exceptions in IFRS 1 as a result of the amendments it proposes to make to IAS 37 because:

(a) IFRS 1 provides no exceptions to the requirements in IAS 37, other than the exemptions from the requirements in IFRIC 1 described in paragraph BC97; and

(b) the amendments proposed in the Exposure Draft would not fundamentally change the requirements in IAS 37 or the procedures or judgements necessary to apply those requirements.

Disclosure—Subsidiaries without public accountability

BC101 Eligible subsidiaries can choose to apply the reduced disclosure requirements in IFRS 19 *Subsidiaries without Public Accountability: Disclosures* instead of the more extensive disclosure requirements in other IFRS Accounting Standards.[6]

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5 See paragraph BC63C of the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

6 A subsidiary is eligible if:

- it does not have public accountability; and
- it has an ultimate or intermediate parent that produces consolidated financial statements available for public use that comply with IFRS Accounting Standards.

BC102 When the IASB proposes new or amended disclosure requirements for other IFRS Accounting Standards it considers whether to include those requirements in IFRS 19. It judges whether including them would provide useful information to users of eligible subsidiaries' financial statements. In doing so, the IASB:

(a) applies guiding principles set out in paragraph BC33 of the Basis for Conclusions on IFRS 19; and

(b) assesses the costs and benefits of the new or amended disclosure requirements based on the needs of those users.

BC103 The IASB has considered whether to add to IFRS 19 the two disclosure requirements it proposes to add to IAS 37.

BC104 As set out in Appendix B to the Exposure Draft, the IASB proposes to add to IFRS 19 a requirement to disclose the discount rate or rates used in measuring a provision. This proposal reflects:

(a) the guiding principle that information on measurement uncertainties —for example, significant judgements and estimates—is important for eligible subsidiaries;

(b) the fact that IFRS 19 requires disclosure of the discount rates used in measuring other assets and liabilities; and

(c) the IASB's assessment that the costs of disclosing discount rates used would be low, because the information is readily available and not commercially sensitive.

BC105 The IASB proposes not to add to IFRS 19 a requirement to disclose the approach used to determine discount rates. The IASB noted that IFRS 19 does not require disclosure of this information for most other assets and liabilities (the only exception being insurance contract liabilities) and concluded that the costs of providing this information would exceed the benefits to the users of eligible subsidiaries' financial statements.

Consequential amendments to other IFRS Accounting Standards

BC106 As a consequence of its proposals to amend IAS 37, the IASB also proposes amendments to other IFRS Accounting Standards. As set out in Appendix B to the Exposure Draft, it proposes:

(a) to remove from IFRS 3 *Business Combinations* an exception to its recognition principle, as explained further in paragraphs BC107–BC110; and

(b) to make minor amendments to several IFRS Accounting Standards that refer to IAS 37. The aim of these amendments would be to align the wording of the references in those other Standards with the amended wording in IAS 37.

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Consequential amendment to IFRS 3

BC107 Two recognition principles underpin the requirements in IFRS 3 for recognising assets and liabilities acquired in a business combination:

(a) at the acquisition date, the acquirer recognises the identifiable assets it has acquired and the liabilities it has assumed, recognising items that meet the definition of an asset or a liability as set out in the *Conceptual Framework*;[7] and

(b) after the acquisition date, the acquirer accounts for those assets and liabilities in accordance with the applicable IFRS Accounting Standard for those items, depending on their nature.[8]

BC108 Currently, the recognition requirements in IAS 37 and IFRIC 21 are not consistent with the *Conceptual Framework*. Some items that meet the definition of a liability in the *Conceptual Framework* do not meet the definition applied in the present obligation recognition criterion in IAS 37. As a result, an acquirer applying the recognition principles in IFRS 3 might recognise a provision on acquisition and then be required to derecognise that provision immediately after the acquisition.

BC109 To avoid this outcome, paragraphs 21A–21C in IFRS 3 provide an exception to the initial recognition principle. The exception applies to liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if they were incurred separately rather than assumed in a business combination. The exception specifies that an entity applies IAS 37 or IFRIC 21 (instead of the *Conceptual Framework*) to determine whether to recognise a liability for those items at the acquisition date.

BC110 As discussed in paragraphs BC34–BC36, the IASB proposes to amend the requirements supporting the present obligation recognition criterion in IAS 37, to align them with the *Conceptual Framework*. It also proposes to withdraw IFRIC 21. These amendments would eliminate the inconsistency between the IFRS 3 recognition principle and IAS 37 recognition criteria, rendering the exception in IFRS 3 redundant. Consequently, the IASB proposes to remove the exception by deleting paragraphs 21A–21C from IFRS 3.

Costs and benefits of the proposed amendments

BC111 The IASB has assessed the likely costs and benefits of possible amendments to IAS 37 throughout the development of the proposals in the Exposure Draft.

BC112 Before deciding to add a project to amend IAS 37 to its work plan, and in determining the project scope and objectives, the IASB identified a list of potential shortcomings in IAS 37. The IASB then sought stakeholder views on whether the benefits of amendments would exceed the costs for each shortcoming. The scope of the project includes only matters on which there was consensus among stakeholders that the benefits would exceed the costs.[9]

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7 See paragraphs 10–11 of IFRS 3.

8 See paragraph 54 of IFRS 3.

9 IASB meeting, January 2020, Agenda Paper 22 *Provisions—Project proposal*.

BC113 In reaching its tentative decisions on this project, the IASB considered the costs and benefits of various options for each of the proposed amendments and for the transition requirements. Likely costs and benefits were identified using information gathered from stakeholders and explained in the staff papers prepared for the meetings at which the IASB made its tentative decisions.

BC114 Table 1 sets out the IASB's assessment of the most significant costs and benefits of the amendments proposed in the Exposure Draft. The IASB is publishing the Exposure Draft having reached a view that the benefits would exceed the costs.

Table 1—Likely costs and benefits of the amendments proposed in the Exposure Draft

	Amendment	Likely costs	Likely benefits
(a)	Updated liability definition.	Initial application costs to understand the new definition and its practical implications.	Lower ongoing costs resulting from a single, clearer definition in IFRS Accounting Standards.
(b)	Clearer requirements supporting the present obligation recognition criterion.	Initial application costs to understand the new requirements and their practical implications.	Lower ongoing costs and more consistent application.
(c)	New requirements leading to earlier and progressive recognition of some levies.	Initial application costs to understand the new requirements and change an accounting policy. Higher ongoing application costs, because provisions recognised earlier might be subject to greater measurement uncertainty.	More useful information for investors, helping them to assess an entity's future cash flows.
(d)	Withdrawal of IFRIC 6, IFRIC 21 and two agenda decisions. Addition of their fact patterns to the *Guidance on implementing IAS 37*.	Initial application costs to become familiar with the new structure.	Easier ongoing application resulting from all IAS 37 requirements and guidance being consolidated in one place.

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	Amendment	Likely costs	Likely benefits
(e)	Requirements for threshold-triggered costs.	Initial application costs to change an accounting policy. Higher ongoing application costs, because provisions recognised earlier might be subject to higher measurement uncertainty.	Clearer requirements reducing application costs and promoting more consistent application. More useful information for investors, helping them to assess an entity's future cash flows.
(f)	More specific discount rate requirements.	Initial application costs to change an accounting policy.	Less diversity in practice and less subjectivity in measurements, improving comparability between entities.
(g)	Requirement for an entity to disclose the discount rates it uses and its approach to determining those rates.	Ongoing application costs for entities to provide this additional information. The IASB expects that these costs will not be high because the information is readily available and is not commercially sensitive.	Useful information for investors and increased transparency, improving comparability between entities.

Appendix A—Functions and sources of proposals in paragraphs 14A–16

BCA1 This appendix provides a paragraph-by-paragraph explanation of the proposed amendments to the requirements supporting the present obligation recognition criterion (paragraphs 14A–16).

BCA2 For each of those paragraphs, it provides:

(a) a cross-reference to the source of the proposed requirements, which is typically an existing paragraph in IAS 37 or a paragraph in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*); and

(b) an explanation of the contribution the paragraph makes to achieving the overall objectives of the amendments, as discussed in paragraphs BC26–BC47.

BCA3 References to IAS 37 and the *Conceptual Framework* use shorthand labels:

(a) IAS 37.x refers to paragraph x of IAS 37; and

(b) CF.4.x refers to paragraph x of Chapter 4 of the *Conceptual Framework*.

Table A1—Paragraph-by-paragraph explanations

Exposure Draft paragraph	Function and source	Contribution to overall aims
14A	Identifies three conditions within the present obligation recognition criterion, reflecting those in CF.4.27.	Replaces the requirement for an obligating event with three distinct conditions.
14B	Defines an 'obligation', using and expanding on the definition in CF.4.29.	Clarifies that the 'no practical ability to avoid' requirement refers to an entity's ability to avoid discharging a responsibility if it obtains specific benefits or takes a specific action, not its ability to avoid obtaining those benefits or taking that action.
14C	Identifies the mechanisms that create obligations using the existing definitions in IAS 37.10.	Links the obligation condition to the definitions of legal and constructive obligations.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14D	Provides examples of economic benefits and actions, building on those listed in CF.4.44 and some illustrated in the *Guidance on implementing IAS 37*.	Clarifies the meaning of two terms used in describing both the obligation condition (paragraph 14B) and the past-event condition (paragraph 14N).
14E	Retains the first part of IAS 37.20 with minor edits to make the wording consistent with CF.4.29.	Improves clarity and editorial consistency with no substantive changes.
14F	Explains the meaning of 'no practical ability to avoid'. Replaces IAS 37.17(a) with analysis from IFRS Interpretations Committee Agenda Decision *Negative Low Emission Vehicle Credits* (IAS 37). Integrates concepts from CF.4.34. Retains IAS 37.17(b).	Clarifies the circumstances in which an entity has no practical ability to avoid a legal obligation. Retains existing requirements related to constructive obligations.
14G	Retains IAS 37.22.	Clarifies that a law gives rise to an obligation when it has been enacted or is virtually certain to be enacted.
14H	Retains the second part of IAS 37.20.	Explains why a board decision is not enough to give rise to a constructive obligation.
14I–14J	Integrates concepts from CF.4.36–CF.4.37.	Explicitly includes and explains the transfer condition in the definition of a liability.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14K	Integrates concepts from CF.4.38.	Explains how the transfer condition in the present obligation recognition criterion in paragraph 14(a) of IAS 37 works alongside the probable transfer recognition criterion in paragraph 14(b) of IAS 37.
14L	Develops concepts from CF.4.39(c) (an example of an obligation to transfer an economic resource), and CF.4.47 and CF.4.57 (description of obligations in executory contracts).	Clarifies existing requirements. Explains why an executory contract (or any other type of obligation to exchange economic resources) meets the recognition criteria only if the contract (or other type of obligation) is onerous.
14M	Repeats new paragraph 14A(c).	Introduces the discussion of the past-event condition.
14N	Replaces IAS 37.19 with new requirements using concepts from CF.4.43.	Redescribes the past-event condition.
14O	Adds clarifying details from CF.4.44.	Describes the circumstances in which the past-event condition is met over time.
14P	Specifies application requirements for threshold-triggered costs, interpreting the general requirements proposed in paragraphs 14N–14O.	Promotes consistent application of the general requirements.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14Q	Specifies requirements for obligations that arise only if an entity takes two or more separate actions. The requirements are based on concepts from CF.4.32. In the *Conceptual Framework*, these concepts are in the section discussing the obligation condition because, like the obligation condition, they apply a 'no practical ability to avoid' threshold. However, they apply that threshold in the context of the past-event condition, so the IASB proposes to include the requirements in the past-event section of IAS 37.	Replaces IFRIC 21 *Levies* with requirements that would result in earlier and progressive recognition of some annual levies and, therefore, more useful information about those levies.
14R	Integrates concepts from CF.4.33, which supports CF.4.32.	Provides further guidance on how to interpret 'no practical ability to avoid' in the past-event condition.
14S–14T	Uses concepts in CF.4.45 to clarify that the enactment of a law or an action that creates a constructive obligation is not sufficient to create a present obligation.	Clarifies the existing requirements. Helps explain that the announcement of a commitment is not sufficient for the entity to recognise a provision, as illustrated in Example 15 Climate-related Commitments in Section C of the proposed amendments to the *Guidance on implementing IAS 37*.

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Exposure Draft paragraph	Function and source	Contribution to overall aims
14U	Retains IAS 37.21, renumbered and with edits to make the terminology consistent with the preceding paragraphs.	Retains the clarification that events (obtaining specific economic benefits or taking a specific action) that do not give rise to a present obligation immediately might do so at a later date.
15–16	Retains the requirements for circumstances in which it is unclear whether the present obligation recognition criterion is met because it is unclear whether specific events occurred or how the law applies to those events. Some text has been reworded.	The rewording ensures that the requirements allow for the possibility that the uncertainty could relate to any of the three conditions in the present obligation recognition criterion. This possibility is shown explicitly in the proposed new decision tree in Section B1 of the *Guidance on implementing IAS 37*.

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Appendix B—Non-performance risk—Conceptual considerations

BCB1 The IASB proposes to require an entity to discount a provision at a rate that excludes non-performance risk (see paragraphs BC75–BC80).

BCB2 In reaching this decision, the IASB considered arguments that a rate that includes non-performance risk:

(a) can be justified conceptually and results in information that could be useful to investors; and

(b) can be viewed as consistent with both:

(i) the measurement objective of IAS 37; and

(ii) the requirement in paragraph 47 of IAS 37 to reflect risks 'specific to the liability'.

BCB3 However, the IASB noted it can be argued that a rate that excludes non-performance risk also fulfils these criteria.

BCB4 This appendix explains these observations further.

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Table B1—Conceptual justification and information provided to investors

(a) Non-performance risk excluded
If the discount rate for a provision excludes non-performance risk, the measure of the provision tells investors the amount the entity would need to invest in risk-free assets at the reporting date to fund the settlement of a provision that has been measured at its certainty equivalent amount, as described in paragraph BC68(a). Provisions within the scope of IAS 37 have a characteristic that justifies treating them differently from liabilities that arise from exchange transactions. Provisions within the scope of IAS 37 (for example, asset decommissioning obligations) typically do not include an obligation for an entity to pay the counterparty compensation for accepting non-performance risk. By discounting a provision (and hence unwinding the discount) at a rate that excludes non-performance risk, an entity faithfully represents the fact that it does not incur an expense for transferring that risk—that is, it does not have to pay the counterparty a premium for accepting the risk.
(b) Non-performance risk included
If the discount rate for a provision includes non-performance risk, the measure of the provision reflects the economic value of the entity's obligation (and the counterparty's claim), making the provision more comparable with liabilities measured at a market value. The measure of the provision tells investors that the liability is less onerous than an otherwise identical liability that requires the entity to pay a non-performance risk premium. The non-performance risk adjustment in the discount rate tells investors the level of non-performance risk associated with the provision. This risk exists and transfers to the counterparty regardless of whether the entity compensates the counterparty for accepting the risk.

Table B2—Consistency with the measurement objective of IAS 37

(a) Non-performance risk excluded
Paragraph 36 of IAS 37 describes the measurement objective as 'the best estimate of the expenditure required to settle the present obligation'. This amount does not reflect the probability that the entity will fail to settle the obligation.
(b) Non-performance risk included
Paragraph 37 of IAS 37 supplements the measurement objective. It describes the measurement objective as 'the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time'. This amount would reflect the probability that the entity will fail to settle the obligation.

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Table B3—Requirement to reflect risks 'specific to the liability'

(a) Non-performance risk excluded
It can be argued that non-performance risk is not specific to the liability because it does not depend solely on the characteristics of the liability. It also depends on the credit standing of the entity that owes the liability.
(b) Non-performance risk included
It can be argued that non-performance risk is specific to the liability because it depends in part on the characteristics of the liability—for example, where the liability would rank relative to other liabilities in a liquidation.

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